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No. 80-1917

IN THE

Supreme Court of the United States

October Term, 1980

PENNSYLVANIA GAS AND WATER COMPANY,
Petitioner,

v

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent.

[35 May Term, 1978]

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF PENNSYLVANIA

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QUESTIONS PRESENTED

1. A public utility financed a portion of its facilities with a payment received as compensation for highway construction damages to its water system. May the public utility, consistent with the Fourteenth Amendment, be denied a return on and recovery through depreciation expense of its investment in facilities financed with the highway damage payment?

2. A lower state court entered on the same day consistent decisions in two appeals involving the same constitutional issue. A state regulatory commission, respondent in both lower court appeals, simultaneously filed petitions for allowance of appeal in each case with the state's highest court. May such court, consistent with the Fourteenth Amendment, grant one of the two appeals and enter an opinion resulting in the affirmance of the lower court's constitutional ruling and thereafter grant the other appeal and enter an opinion reversing the lower court's ruling on the identical constitutional issue?

3. A state regulatory commission filed a petition for allowance of appeal with the state's highest court from a lower court decision reversing its ratemaking order. May such court, consistent with the Fourteenth Amendment, grant such appeal approximately three years after it was requested, issue a decision reversing the lower court's decision almost five years after it was entered and then delay acting on a petition for reargument for more than a year after its filing?

LIST OF ALL PARTIES

Review is sought of the February 1, 1980 judgment and opinion of the Supreme Court of Pennsylvania in the case of *Pennsylvania Public Utility Commission v. Pennsylvania Gas and Water Company,* No. 35 May Term, 1978.[1] The parties to the proceeding below included Pennsylvania Gas and Water Company (PG&W) [2] and the Pennsylvania Public Utility Commission (PUC).[3] PG&W filed an application for reargument with respect to the February 1, 1980 judgment and opinion. Applications for reargument were also filed as amici curiae by the National Association of Water Companies—Pennsylvania Chapter, Pennsylvania Gas Association, Mechanicsburg Water Company, Philadelphia Suburban Water Company, T. W. Phillips Gas and Oil Company, Western Pennsylvania Water Company and Equitable Gas Company. All applications were denied February 18, 1981.

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1. The Supreme Court of Pennsylvania issued a consolidated opinion at No. 35 May Term, 1978 and No. 278 January Term, 1978, with the latter appeal involving a subsequent PG&W water rate increase. The facts and issues at No. 35 May Term, 1978, the subject of this Petition, were separate and distinct from those at No. 278 January Term, 1978. A separate Petition is being filed with this Court from No. 278 January Term, 1978.

2. PG&W is now a wholly-owned subsidiary of Pennsylvania Enterprises, Inc., which is a holding company with two groups of subsidiaries: One group includes PG&W and its five subsidiaries (Trucksville Water Company, Hillcrest Water Co., Homesite Water Company, Shavertown-Kingston Township Water Company and Penn Gas Development Co.) and the other group includes Pennsylvania Energy Resources, Inc. and Theta Land Corporation.

3. The City of Scranton (City) and County of Lackawanna (County) were parties before the Commonwealth Court of Pennsylvania and although listed in the caption below did not participate.

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No.

IN THE

Supreme Court of the United States

October Term, 1980

PENNSYLVANIA GAS AND WATER COMPANY,
Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent.

[No. 35 May Term, 1978]

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF PENNSYLVANIA

Petitioner, Pennsylvania Gas and Water Company, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the Supreme Court of Pennsylvania entered on February 1, 1980, in the case of *Pennsylvania Public Utility Commission v. Pennsylvania Gas and Water Company,* No. 35 May Term, 1978.[4]

4. See footnote 1, *supra.*

OPINIONS BELOW

The opinion of the Supreme Court of Pennsylvania (the "court below") is reported at — Pa. —, 424 A. 2d 1213 (1980) and together with the concurring opinions appears as Appendix A hereto. Notice of denial of the applications for reargument appears as Appendix B. The opinion of the Commonwealth Court of Pennsylvania (Commonwealth Court) which was reversed by the court below is reported at 19 Pa. Commonwealth Ct. 214, 341 A. 2d 239 (1975) and appears as Appendix C, together with a dissenting opinion. The order of the PUC which was reinstated by the court below is reported at 47 Pa. P. U. C. 750 (1974). The portion of the order pertaining to the issue raised herein appears as Appendix D.

JURISDICTION

The opinion of the court below was entered on February 1, 1980, and its order denying reargument was entered on February 18, 1981. The jurisdiction of this Court is invoked under Title 28 of the United States Code § 1257(3).

CONSTITUTIONAL PROVISION INVOLVED

U. S. Constitution, Amendment XIV, Sec. 1:

> ". . . nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

STATEMENT OF THE CASE

PG&W is a Pennsylvania public utility corporation providing both water and gas service to the public in Northeastern Pennsylvania subject to regulation by the PUC, an administrative agency of the Commonwealth of Pennsylvania (Commonwealth).

In the 1960's, the Commonwealth acting through its Department of Highways (later named Department of Transportation) proposed highway construction which because of the turbidity it would create would render useless portions of PG&W's water system including a reservoir, several wells, and a thirteen square mile area of watershed as a source of water supply. The highway construction would have destroyed PG&W's water supply to the City of Scranton.

After extensive negotiations, an agreement was reached in 1969 whereby the Commonwealth agreed to pay PG&W $2,754,754 for damages which would be inflicted on its water system by the highway construction. The basis employed for determining this amount was the "cost-to-cure" method, i.e., the estimated cost to replace that portion of the system to be rendered useless as a result of the highway construction.[5] With the damage proceeds and substantial additional investor supplied capital, PG&W constructed a reservoir and a thirty-inch pipeline to replace the affected portion of its system and to provide additional capacity.

On January 30, 1973, PG&W filed with the PUC a proposed water rate increase including in its rate base and depreciation expense claims the investment in the facilities

5. The "cost-to-cure" method had previously been found by the court below to be appropriate for determining damages to a water utility's property caused by highway construction. See *Pennsylvania Gas and Water Co. v. Pennsylvania Turnpike Commission*, 428 Pa. 74, 236 A. 2d 112 (1967).

financed with the damage payment. In its final order dated July 9, 1974 at R. I. D. 72 (Appendix D), the PUC disallowed $628,313 of the proposed rate increase, based in part on the exclusion of $2,558,634 from consideration in the determination of the rate base and depreciation expense findings. The $2,558,634 represented the investment in the new facilities financed by the damage payment after deducting from the total damage payment the depreciated original cost of the property rendered useless. Although PG&W had contended that such a holding would be a violation of the Fourteenth Amendment, the PUC's order did not address the constitutional issue.

PG&W petitioned the Commonwealth Court for review of the PUC's order contending, *inter alia*, that the exclusion from rate base and disallowance of the depreciation expense amounted to confiscation of its property.[6] By order and opinion dated May 27, 1975 (hereinafter "*PG&W* opinion") (Appendix C), the Commonwealth Court affirmed with one exception the PUC's order. It reversed the order as to the treatment of the facilities financed with the highway damage payment and held that the exclusion thereof from the PUC's ratemaking findings was a violation of due process, citing its discussion in its companion opinion in *Keystone Water Co., White Deer District v. Pa. P. U. C.*, 19 Pa. Commonwealth Ct. 292, 339 A. 2d 873 (1975) (hereinafter "*Keystone* opinion"). The *Keystone* opinion, Appendix E hereto, involved the same issue and was filed simultaneously with the *PG&W* opinion on May 27, 1975.

On June 26, 1975, the PUC petitioned the court below for allowances of appeal from both the Commonwealth Court's *PG&W* and *Keystone* opinions, raising in each

6. The City and County, raising different issues, also petitioned for Commonwealth Court review of the PUC's order. See footnote 3, *supra*.

petition precisely the same contentions. Without taking any action on the petition from the *PG&W* opinion, the court below granted the allowance of appeal from the *Keystone* opinion and affirmed that opinion by an equally divided court on April 7, 1978, in *Keystone Water Co., White Deer District v. Pa. P. U. C.*, 477 Pa. 594, 385 A. 2d 946 (1978), which opinion appears as Appendix F. Following its *Keystone* decision, the court below on June 21, 1978, approximately three years after its filing, granted the PUC's petition for allowance of appeal from the Commonwealth Court's *PG&W* opinion.

On February 1, 1980, almost five years after the Commonwealth Court's *PG&W* opinion was entered, the court below by a judgment and opinion (Appendix A), directly contrary to the affirmance in the *Keystone* appeal, reversed the Commonwealth Court's *PG&W* opinion on the highway damage payment issue and reinstated the PUC's July 9, 1974 order.

PG&W filed with the court below an application for reargument contending that the decision was in error and in violation of its constitutional rights. On February 24, 1981, over one year after its filing, the application for reargument was denied (Appendix B).

The federal constitutional issue involving the ratemaking treatment of the highway damage payment was timely and properly raised. It was raised initially before the PUC, though not addressed in its order. It was also subsequently raised before and addressed by both the Commonwealth Court (see Appendix C, pp. A31, A32 and Appendix E, pp. A75-A83 referred to therein) and the court below (see Appendix A, pp. A9-A16).

REASONS FOR GRANTING THE WRIT

I. The Court Below Misinterpreted the Issue and Its Opinion Results in Confiscation of Private Property.

In its opinion, the court below stated the issue to be "the correct standard to be employed" in fixing the value of the rate base property (Appendix A, p. A1). It then proceeded with a discussion as to whether the Fourteenth Amendment requires consideration to be given to reproduction cost in determining the value of a public utility's rate base. The court concluded that such consideration need not be given and reinstated the PUC order denying PG&W a return on and recovery of its investment in the facilities financed with the highway damage payment proceeds.

The court below's statement of the issue to the contrary notwithstanding, there was no issue as to any constitutional requirement in respect to the weight to be given reproduction cost in arriving at rate base. The issue was whether it is permissible to deny a public utility a return on and recovery through depreciation expense of its investment in property constructed and financed with proceeds from a damage payment made to replace the portions of its system which would be rendered useless as a result of highway construction. This was specifically recognized by the Commonwealth Court in the *Keystone* opinion (Appendix E, p. A75).

> "... The question before us in this case, however, is not whether the value allowed for rate-making purposes by the PUC was one of several possible valuations, but rather, whether the PUC's action in entirely eliminating this piece of property from the rate base was proper."

The decisions of this Court reveal that such action is confiscatory in violation of the Fourteenth Amendment.

As early as 1886, this Court in *Stone v. Farmers Loan and Trust Company,* 116 U. S. 307, 331 (1886) held:

> "From what has thus been said it is not to be inferred that this power of limitation or regulation is itself without limit. *This power to regulate is not a power to destroy, and limitation is not the equivalent of confiscation.* Under pretense of regulating fares and freights, the State cannot require a railroad corporation to carry persons or property without reward; *neither can it do that which in law amounts to a taking of private property for public use without just compensation or without due process of law.*" (emphasis added)

In subsequent decisions, this Court has recognized that it is the capital investment which comprises the rate base and it is this investment that cannot be confiscated. As stated by Justice Brandeis in the concurring opinion in *Missouri ex rel. S. W. Bell Telephone Co. v. Public Service Commission of Missouri,* 262 U. S. 276, 290 (1923):

> "The thing devoted by the investor to the public use is . . . *capital embarked in the enterprise.* Upon the capital so invested the Federal Constitution guarantees to the utility the opportunity to earn a fair return." (emphasis added)

Also, see *Federal Power Commission v. Hope Natural Gas Co.,* 320 U. S. 591, 603 (1944) which cited this opinion of Justice Brandeis, and *Market Street Railway Company v. Railroad Commission of the State of California,* 324 U. S. 548, 567 (1945).

Furthermore, this Court in *Lindheimer v. Illinois Bell Telephone Company,* 292 U. S. 151, 167 (1934), recog-

nized that the Fourteenth Amendment requires "an allowance for consumption of capital" through depreciation expense "in order to maintain the integrity of the investment in the service rendered."

The $2,558,634 damage proceeds in issue were without question the property of PG&W and its investors. Had PG&W not been a public utility with a legal duty to render adequate service, the damage proceeds could have been distributed in the form of dividends to its stockholders. The damage proceeds, however, were reinvested to construct new facilities to assure that adequate service was maintained. Under the aforementioned decisions of this Court, the failure to allow any return whatsoever on this investment, as well as the recovery of the associated depreciation expense, violates the Fourteenth Amendment.

The effect of the decision below is to give private property to the ratepayer, which is contrary to this Court's decision in *Board of Public Utility Commissioners v. New York Telephone Company*, 271 U. S. 23, 32 (1926):

> "Customers pay for service, not for the property used to render it. . . . By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company."

It is respectfully submitted that this constitutional violation should not be allowed to stand.

II. The Action of the Court Below in Rendering Inconsistent Opinions on Appeals Simultaneously Filed Involving the Same Issue Is a Violation of Both Due Process and Equal Protection of the Laws.

"[D]ue process of law and the equal protection of the laws" this Court has held "are secured if the laws operate

on all alike, and do not subject the individual to an arbitrary exercise of the powers of government." *Duncan v. State of Missouri*, 152 U. S. 377, 382 (1894). To satisfy the due process and equal protection guarantees, the appellate process must operate uniformly on all parties similarly situated. As this Court held in *Barbier v. Connolly*, 113 U. S. 27, 31 (1885):

> "The 14th Amendment, in declaring that no State 'Shall deprive any person of life, liberty or property without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws,' undoubtedly intended, not only that there should be no arbitrary deprivation of life or liberty or arbitrary spoliation of property but that equal protection and security should be given to all under like circumstances in the enjoyment of their personal and civil rights; that all persons should be equally entitled to pursue their happiness and acquire and enjoy property; that they should have like access to the courts of the country for the protection of their persons and property, the prevention and redress of wrongs, and the enforcement of contracts; that no impediment should be interposed to the pursuits of anyone except as applied to the same pursuits by others under like circumstances; that no greater burdens should be laid upon one than are laid upon others in the same calling and condition . . ."

These Fourteenth Amendment requirements were violated in the inconsistent holdings by the court below. Here, the Commonwealth Court on May 27, 1975, entered both its *PG&W* and *Keystone* opinions holding that the PUC's ratemaking exclusion of property financed with a highway damage payment was in violation of the Fourteenth Amendment. On June 26, 1976, the PUC filed with

the court below petitions seeking allowances of appeal from both the Commonwealth Court's *PG&W* and *Keystone* opinions, which petitions raised precisely the same contentions. The Court below in a timely fashion proceeded to grant the appeal from the *Keystone* opinion and rendered its decision at *Keystone Water Company, White Deer District v. Pa. P. U. C.*, 477 Pa. 594, 385 A. 2d 946 (1978) (Appendix F), affirming by an equally divided court the Commonwealth Court's *Keystone* opinion that the PUC's ratemaking exclusion of property financed with a highway damage award *was* a violation of due process.

In sharp contrast, the court below delayed the granting of the appeal from the *PG&W* opinion for approximately three years and approximately a year and one-half thereafter issued its decision reversing the opinion and finding that the PUC's ratemaking exclusion of property financed with a highway damage award was *not* a violation of due process. Thus, in appeals simultaneously filed before the same court, the utility in one was allowed a return and depreciation while the utility in the other was not.

Under the circumstances, the action of the court below in rendering two totally inconsistent decisions in appeals filed on the same day, by the same party and involving the same issue is a violation of the Fourteenth Amendment.[7]

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7. This is not a situation such as *Fidelity & Columbia Trust Company v. City of Louisville*, 245 U. S. 54 (1917), where the appellate court reversed one of its earlier decisions. The inconsistent decisions rendered by the court below involved appeals filed on the same day by the same party and it was only as a result of the court delaying action on the *PG&W* opinion that its decision below was rendered subsequent to its decision in *Keystone Water Co., White Deer District v. Pa. P. U. C., supra.*

III. The Long and Unjustified Delay of the Court Below in Deciding the Case Is a Violation of Both Due Process and Equal Protection of the Laws.

As recognized on many occasions by this Court, the limitations imposed by the constitutional requirements of due process and equal protection of the laws extend to the judicial branch of government. See e.g., *Shelley v. Kraemer,* 334 U. S. 1 (1948). The judicial branch in carrying out these requirements must not act arbitrarily in processing appeals of persons similarly situated. *Duncan v. State of Missouri,* 152 U. S. 377 (1894). In light of the action of the court below in processing its decision in *Keystone Water Co., White Deer District v. Pa. P. U. C., supra,* in a much more timely fashion, the inordinate and arbitrary delay of the court below in this case is so flagrant that it should shock the judicial conscience as an outright violation of both due process and equal protection of the laws.

The court below took over five and one-half years to finally dispose of the appeal from the Commonwealth Court's May 27, 1975 *PG&W* opinion. The court did not act on the PUC's petition for allowance of appeal for approximately three years; it did not enter its judgment and opinion for approximately one and one-half years following the granting of the appeal; and it did not take action on PG&W's application for reargument for over a one-year period.

This arbitrary and unjustified delay is particularly egregious to PG&W. Over the last six years, PG&W has been collecting rates in accordance with the Commonwealth Court's May 27, 1975 *PG&W* opinion. The action of the court below in reversing the *PG&W* opinion some five years after it was entered has exposed this public utility to a claim for refunds involving the reasonableness of the water rates collected during the entire period.

The court below has so far departed from the accepted and usual course of judicial proceedings that PG&W's constitutional rights have been violated.

CONCLUSION

For all of the foregoing reasons a writ of certiorari should issue to review the judgment and opinion of the Supreme Court of Pennsylvania

Respectfully submitted,

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APPENDIX A.

IN THE
SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT AND EASTERN DISTRICT

No. 35 May Term, 1978

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

v.

PENNSYLVANIA GAS AND WATER COMPANY
(WATER DIVISION),
Appellee

CITY OF SCRANTON, et al.

v.

PENNSYLVANIA GAS AND WATER COMPANY,
(WATER DIVISION)

Appeal from Order of the Commonwealth Court of Pennsylvania, Dated May 27, 1975, at Nos. 1092, 1122, 1123 C.D. 1974, Reversing in Part of the Order of the Pennsylvania Public Utility Commission at R.I.D. 72, Dated July 9, 1974.

No. 278 January Term, 1978

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

v.

PENNSYLVANIA GAS AND WATER COMPANY—
WATER DIVISION
Appellee

OFFICE OF CONSUMER ADVOCATE

and

PENNSYLVANIA ATTORNEY GENERAL,

Intervenors

Appeal from the Order of the Commonwealth Court Dated December 21, 1977, at No. 1523 Commonwealth Docket 1976, Reversing the Order of the Pennsylvania Public Utility Commission at Rate Investigation Docket No. 209, Dated August 4, 1976.

Opinion

(Filed February 1, 1980)

NIX, *J.*

These two appeals present this Court with the troublesome issue of the correct standard to be employed by the Public Utility Commission (PUC) in fulfilling its legislative mandate to "ascertain and fix the fair value of the whole or any part of the property of any public utility." Act of May 28, 1937, P. L. 1053, art. III, § 311, 66 P. S. § 1151 (1958) [1] (the Act). For the reasons that follow, we are of the view that the PUC was correct in its determination and that its orders should not have been disturbed. Accordingly, we reverse the orders of the Commonwealth Court below.

The complex facts surrounding these appeals are fully set forth in the opinions of the Commonwealth Court.[2] For our purposes, the following brief factual reci-

(1) This Act was repealed by the Public Utility Code of 1978, 66 Pa. C. S. A. §§ 1 *et seq.*, effective August 29, 1978. The instant appeals are concerned solely with the 1937 Act.

(2) The opinion of the Commonwealth Court in No. 35 May Term 1978 (PG&W I) is set forth at 19 Pa. Commw. Ct. 214, 341

tation is sufficient. The appeal at No. 35 May Term 1978 (PG&W I) concerns construction and improvement projects undertaken by the Pennsylvania Department of Highways that were anticipated to affect the water supply of the Pennsylvania Gas & Water Company (PG&W) within its Roaring Brook watershed area. An agreement was entered into between the Department and PG&W to remedy and minimize the adverse effect of this federally funded highway project on the turbidity and purity of the water derived from the watershed. This agreement provided that the Department would contribute to PG&W a sum in excess of $2.7 million toward the construction of a new dam, reservoir, and a 30-inch pipeline. The PUC rejected the attempt by PG&W to include this $2.7 million payment in its base for accounting and rate making purposes.[3] The Commonwealth Court reversed the PUC on the ground that the exclusion of the $2.7 million payment from the rate base constituted a violation of the principles enunciated in *Keystone Water Co. v. PUC,* 19 Pa. Commw. Ct. 292, 339 A. 2d 873 (1975), affirmed by an equally divided Court, 477 Pa. 594, 385 A. 2d 946 (1978). We granted the PUC's petition for allocatur.

The appeal at No. 278 January Term 1978 (PG&W II) concerns PG&W's request for a two-step increase in its rates. The PUC approved the first step, but disallowed the second step after ascertaining and fixing PG&W's rate base at $87,700,000 and allowing it a return of 8.53 per cent. The Commonwealth Court reversed the PUC, find-

2. (Cont'd.)
A. 2d 239 (1975). The opinion of that court in No. 278 January Term 1978 (PG&W II) is found at 33 Pa. Commw. Ct. 143, 381 A. 2d 996 (1977).

(3) By including this payment into its base, PG&W could pass this windfall on to its stockholders and *also* request higher rates from the public in order to compensate for the injury to its watershed.

ing that the PUC's determination of the fair value of PG&W's rate base was legally incorrect in view of its earlier opinions in the *PG&W I* and *Keystone*. We granted the PUC's petition for review and the petitions to intervene filed by the Attorney General and the Office of Consumer Advocate, and ordered the matters to be argued together.

1. The Appeal at No. 35 May Term, 1978

Before we discuss the legal and historical basis surrounding the "fair value" controversy, we think it proper to set forth the rationale employed by the PUC in support of its Order rejecting PG&W's attempt to include the state's $2.7 million payment in its base for accounting and rate making purposes:

> For public utility accounting and rate making purposes we must reject respondent's contention. Property, which is used or useful in rendering a public utility service and which has been a part of a public utility's rate base is dedicated to a public use, and is impressed with a public trust. It (or the proceeds or accruals therefrom) is subject to regulation by the properly designated regulatory body and remains subject to that regulation until such time as that regulatory body duly finds it in the public interest to approve its release from public service. Such property must be regulated in the interest of the public no less than in the interest of the utility. Equities must be balanced and justice must be done to all concerned. Accordingly, when a utility suffers extraordinary losses in service value of utility property abandoned or otherwise retired from service, or suffers unforeseen damages to property which damages could not reasonably be anticipated, and where the utility has not otherwise recovered its investment,

this Commission can and, where equities require, does permit the utility to recover from the ratepayers, as a proper and necessary expense of rendering the public service, the necessary amount to make the utility whole. On the other hand, where, as here, the utility recovers an amount or sum as a result of compensation for particular property and the potential consequential injury to the service of the ratepayers for whom that property was dedicated to the public use, the Commission, where the equities dictate, may require that amount received by the utility to be treated, for public utility accounting and rate making purposes, in such manner as will place the utility and the ratepayers in the same position, insofar as reasonably possible, as they were before the extraordinary event or transaction which gave rise to the sum or amount in question.

For rate making purposes, we cannot permit respondent to receive all the salutary effects of the agreement and pass them on to the stockholders as a windfall while passing on to the ratepayers only the increased rates that would become necessary had there been no agreement and contribution. Clearly, the payment in question resulted and stemmed from consideration of the property's dedication to public use as a water utility, and recognition of the potential injury to the interests and service of the water utility customers. In situations and circumstances such as this, the customers of a utility are in the nature of third party beneficiaries whose interest in the utility service must be protected. The essence of public utility regulation is the protection of the public and the assurance of adequate service to them at reasonable rates on the one hand, and, on the other, a fair opportunity to the utility to secure a reasonable rate

and no windfall from such services. To reflect equitably and meaningfully the near restoration of, or equitable substitution for, the pre-agreement status quo, both the utility and its customers must be made whole insofar as reasonably possible.

First, the majority opinions of the Commonwealth Court in *Keystone* and in the instant case reflect a misperception of the regulatory authority of the Commonwealth and its chosen instrumentality for carrying out the desired objectives (the Pa. PUC) and the significance of the notion of deference which accompanies that regulatory scheme. The PUC's functions in valuing utility property [4] and in fixing just and reasonable rates of return thereon [5] are exercises of the regulatory powers of the Common-

(4) *Valuation of property of a public utility*

The commission may, after reasonable notice and hearing, ascertain and fix the fair value of the whole or any part of the property of any public utility, in so far as the same is material to the exercise of the jurisdiction of the commission, and may make revaluations from time to time and ascertain the fair value of all new construction, extensions, and additions to the property of any public utility. When any public utility furnishes more than one of the different types of utility service enumerated in paragraph seventeen of section two of this act [66 P. S. § 1102(17)], the commission shall segregate the property used and useful in furnishing each type of such service, and shall not consider the propery of such public utility as a unit in determining the value of the property of such public utility for the purpose of fixing rates.

Public Utilities Law, § 311, 66 P. S. § 1151.

(5) *Rates to be just and reasonable*

Every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable and in conformity with regulations or orders of the commission.

Id. at § 301, as amended, 66 P. S. § 1141.

wealth. *Cf., Nebbia v. New York,* 291 U. S. 502 (1934). Regulation amounts to a taking when government forces "some people alone to bear public burdens, which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. U. S.,* 364 U. S. 40, 49 (1960). Accordingly, it must be determined whether the PUC's exclusion from PG&W's rate base of a payment made out of public funds to construct a reservoir and pipeline to minimize the effects of a public construction project on the performance of water supply functions which are public in nature, forced PG&W's investors and shareholders alone to bear public burdens which in fairness and justice should have been borne by the utility's rate payers as a whole.

The second deep-rooted fallacy in the Commonwealth Court analysis in this area has to do with confusing valuation for eminent domain purposes with valuation for regulatory purposes. These various processes of valuation are no more necessarily interrelated or interdependent than valuation for real property assessment purposes or any other circumstances in which the law requires valuation of property for the performance of a discrete and separate governmental function. *See generally* Bonbright, Valuation of Property (1937). The mere fact that a particular part of the company's property was valued at its cost of reproduction in an eminent domain award is not dispositive nor controlling as to its proper valuation for regulatory purposes. The purpose of just compensation in eminent domain is to put the owner "in as good a position pecuniarily as it would have occupied, if its property had not been taken." *U. S. v. New River Collieries,* 262 U. S. 341 (1923). But it has been cogently observed that "the purpose of regulating utility rates, unlike that of condemning property, is to correct an economic maladjustment whereby the company owning the property is ad-

judged to have an undue advantage over the rest of the community." Hale, Freedom Through Law—Public Control of Private Governing Power, p. 463.

In the case of water companies, the advantages which they have secured over the rest of the community have stemmed directly from their status as public corporations. *White v. City of Meadville*, 177 Pa. 643, 35 A. 695 (1896). For example, at various times, water companies have been vested with eminent domain taking powers which gave them the right to take streams [6] and to acquire land to preserve their water supply from contamination.[7] So, too, such rights as any water company enjoys to divert water for the purpose of supplying municipalities or other consumers are, because they exceed the common law rights of the riparian owner, wholly public in that they arise by virtue of public eminent domain and regulatory powers. *Lord v. Meadville Water Co.*, 135 Pa. 122, 19 A. 1007 (1890); *Haupt's Appeal*, 125 Pa. 211, 17 A. 436 (1889).

In refusing to include the $2.7 million contribution made by the Commonwealth toward the capital construction costs of the reservoir and pipeline necessitated by the anticipated impact of the federally aided highway construction project in PG&W's rate base, the PUC in effect disallowed PG&W an addition to the original cost measure upon which the property in question was valued. In so doing, PG&W contends that the PUC contravened the controlling statutory norm requiring it "to ascertain and fix the *fair value* of the whole or any part of the property of any public utility." Public Utility Law, § 311, 66 P. S. § 1151 (emphasis supplied). PG&W further contends that this statutory norm of "fair value" either incorporates by

(6) Corporation Act of 1874, Act of April 29, 1874, P. L. 73, No. 32, § 34 as amended by the Act of May 16, 1889, P. L. 226, No. 232.

(7) Act of May 26, 1893, P. L. 158, No. 103.

reference the meaning of that term as adumbrated in *Smyth v. Ames*[8] or, in the alternative, is bottomed on the continuing validity of *Smyth* as a standard for adjudicating the constitutionality of rate regulation under the Federal Constitution.

In construing the statutory norm of fair valuation, we must, of course, view that standard within the context of the enactment as a whole. Accordingly, we find that the overriding principle governing the PUC's performance of its duty is to determine "just and reasonable" rates pursuant to Public Utility Law § 301, 66 P. S. § 1141. *New York Telephone and Telegraph v. PSC*, 309 N. Y. 569, 579-580, 132 NE. 2d 847, 850-51 (1956). Thus, the "fair value" must reflect rates that are "just and reasonable." The rate making function consists of a two-step process to effectuate the paramount responsibility of fix-

(8) 169 U. S. 466 (1898). The holding in *Smyth* reads as follows:

> We hold . . . that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction; the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth. *Id.* at 546.

ing "just and reasonable" rates: fair valuation of utility property and the ascertainment of a reasonable rate thereon. There is ample authority for the proposition that the power to fix "just and reasonable" rates imports a flexibility in the exercise of a complicated regulatory function by a specialized decision-making body and that the term "just and reasonable" was not intended to confine the ambit of regulatory discretion to an absolute or mathematical formulation but rather to confer upon the regulatory body the power to make and apply policy concerning the appropriate balance between prices charged to utility customers and returns on capital to utility investors consonant with constitutional protections applicable to both. *See Utah Power and Light Co. v. PSC*, 107 Utah 155, 190-191, 152 P. 2d 542, 558 (1944). *Accord, State v. N. J. Bell Telephone Co.*, 30 NJ 16, 152 A. 2d 35 (1959).

The opinion in support of affirmance in *Keystone* did not deny the primacy of the "just and reasonable" standard or that it represented a delegation of policy-making powers to the PUC which are basically legislative in nature. That opinion, however, accepted the notion that the term "fair value" was intended to have a fixed meaning incorporating by reference the rule in *Smyth v. Ames*, as interpreted in *Bluefield Water Works v. Public Service Commission*,[9] with respect to the weight of reproduction cost data in rate making. *Keystone*, 477 Pa. at 607-08, 385 A.2d at 953-54.

The legislative history of public utility regulation in this Commonwealth does not support this assertion. The 1913 Public Service Company Law which is the grandfather of the present statute spelled out the meaning of "fair value" by express incorporation of each factor enumerated in *Smyth v. Ames*. Act of July 16, 1913, P. L. 1734, No. 854, art. V, § 20. The purpose of such enumera-

(9) 262 U. S. 679 (1923).

tion was to draft a constitionally valid statute by including therein almost *in ipsis verbis* the constitutional rule concerning rate fixing powers as it was understood at the time that the statute was drafted. *See* Munson, The Public Service Company Law (1914). The 1937 statute superseding the 1913 law significantly omitted any definition or specification of the meaning of "fair value." The Superior Court considered that this omission was consistent with a legislative intent to define "fair value" as synonymous with that concept as expressly defined by the prior statute and in *Smith v. Ames. Solar Electric Co. v. PUC*, 137 Pa. Super. 325, 326, 9 A. 2d 447 (1939). However, this omission is equally consistent with a legislative intent to free itself from the shackles of express adherence to an understanding of the constitutional meaning of "fair value" which was in evolution at the time that the 1937 statute was drafted. *See* Rose, *The Hope Case and Public Utility Valuation*, 54 Col. L. Rev. 188, 195 (1954); Bauer & Gold, Public Utility Valuation for Purposes of Rate Control, p. 155 *et seq.* (1935).

In any event, even assuming *arguendo* that the legislature intended to acquiesce in the "fair value" principle as enunciated in *Smyth v. Ames*, little comfort is thereby afforded to PG&W. The rule in *Smyth v. Ames* fixes the very broad constitutional boundaries within which the legislature may exercise or infer discretionary leeway in rate-making. As a leading commentator observed:

> It is obvious that the instruction that is the essence of 'fair value'—to give the matters for consideration (principally original cost and reproduction cost) such weight as may be just and right—is not operational. It offers no criterion or rule to determine what is 'just and right' and, therefore, does not provide a method to ascertain a uniquely determinate value of the weight to be assigned to each of the 'matters for con-

> sideration' in a finding of fair value. . . . The fact is that *fair value is an indeterminate magnitude lying anywhere between original cost and reproduction cost.* [Emphasis added].
>
> Rose, *Confusion in Valuation for Public Utility Rate Making,* 47 Minn. L. Rev. 1, 23 (1962).

Properly understood, *Smyth v. Ames* speaks only to the outer boundaries beyond which, on the one hand, a regulator approaches an uncompensated eminent domain taking of investor property by valuing it below its original cost and, on the other hand, a regulator approaches an unlawful taxation of consumers under the guise of rate fixing by valuing the property in excess of its reproduction cost. Between these extremes, the question is one of policy for the regulatory body concerning which the judicial branch is not warranted in interposing economic theories. Unless the PUC's decision does not bear a real and substantial relationship to the regulatory objects sought to be obtained by it, that judgment must prevail. *Gambone v. Commonwealth,* 375 Pa. 547, 101 A. 2d 634 (1954); *Pennsylvania State Bd. of Pharmacy v. Pastor,* 441 Pa. 186, 272 A. 2d 487 (1971).

Thus, "fair value" as understood in *Smyth v. Ames* does not compel reversal of the PUC's determination either as a matter of statutory or constitutional law. In the instant case, the PUC duly considered the evidence proffered by PG&W as to the reproduction cost of the watershed properties but concluded that, under the circumstances of the particular case, the allowance of any addition to original cost figures for rate making purposes was not just and reasonable and that the 2.7 million dollar payment should be more appropriately treated as a "contribution," as it was designated by the agreement between PG&W and the Department of Highways, rather than as

an additional investment of capital. As we observed in an earlier case:

> The ascertainment of the fair value of the property, for rate making purposes, is not a matter of formulas, but is a matter which calls for the exercise of a sound and reasonable judgment upon a proper consideration of all relevant facts. The commission is not bound to adopt any one method to the exclusion of all others. It may take into consideration various methods, and use its judgment as to the extent to which they shall be employed. The original cost of the property is not to be taken as controlling, for there may have been extravagance in purchasing, or bad management; and, on the other hand, there may have been an actual increase in values since the original purchase or construction. Then again the reproduction cost, less depreciation, may not give the present fair value of an old property, for it may not now be desirable to reproduce the old type of plant. Improved machinery, and better methods of operation, may have come into vogue, which would make it true economy to relegate much of the physical structure of an old plant to the scrap heap. Much must be left to the sound discretion of the appraising body, the tribunal appointed by law and informed by experience, for the discharge of these delicate and complex duties. Its report must, of course, justify itself in reason, upon review in the appellate courts.
>
> *Ben Avon Boro v. Ohio Valley Water Co.*, 260 Pa. 289 at 308-309, 103 A. 744 (1918).

The error which the Commonwealth Court and the opinion in affirmance in *Keystone* fell into was the assumption of a constitutionally mandated nexus between the "fair value" standard and cost of reproduction figures. The

unsoundness of this assumption is manifested in the fact that this Court denies that reproduction cost figures have any probative value for real property tax assessment purposes because of their hypothetical and speculative nature. *Buhl Foundation v. Bd. of Property Assessment,* 407 Pa. 567, 180 A. 2d 900 (1962); *U. S. Steel Corp. v. Bd. of Assessment & Rev. of Taxes,* 422 Pa. 463, 223 A. 2d 92 (1966). Reproduction cost figures are clearly admissible in PUC proceedings but we see nothing in the "fair value" rule that requires, either as a statutory or constitutional mandate, that they *must be accepted* in whole or in part for valuation purposes. We, therefore, repudiate any intimations in these decisions or in prior case law that has the effect of suggesting a constitutional mandate requiring the inclusion of reproduction cost figures in arriving at the appropriate rate structure in public utility valuation cases.

To follow the Commonwealth Court and the opinion in affirmance in *Keystone* down the path of attempting to apply a constitutional taking analysis to valuations of property by the PUC which do not go beyond original cost, is unsound both in principal and as a matter of judicial policy.

In the former respect, it commits the judicial branch to a constitutionally grounded review of all rate requests in which the PUC has on an item by item basis failed to go beyond original cost valuation. In the case at bar, PG&W sought to include a replacement cost figure *in toto* in the rate base because of the fortuity that the property in question was subject to taking for eminent domain purposes. But if PG&W's entitlement is constitutionally founded, then it must be accorded revaluation at reproduction cost as to every item on its property concerning which it requests revaluation since the maturing of its constitutional rights cannot turn on the mere happenstance of a public taking. It is no answer to say that the

PUC's accounting rules do not permit such a result since the accounting rules as creatures of statute cannot prevail against a constitutionally grounded right.

In the latter respect, the opinions commit us without either statutory or constitutional warrant to a slippery slope of judicial intervention into rate making whose limit we cannot now foresee. We can, call upon the experience of the United States Supreme Court with respect to judicial intervention in these matters as a guide. As Justice Stone warned in his dissenting opinion in *West v. Chesapeake & Potomac Telephone Co.*, 295 U. S. 662, 689 (1935), "In assuming the task of determining judicially the present fair replacement value of the vast properties of public utilities, courts have been projected into the most speculative undertaking imposed upon them in the entire history of English jurisprudence." It is a task which this Court refused to undertake in *Ben Avon Boro, supra* and the wisdom of that judgment was ultimately recognized by the United States Supreme Court in *FPC v. Natural Gas Pipeline Co.*, 315 U. S. 575, 586 (1942) (the Constitution does not bind rate making bodies to the service of any single formula or combination of formulas). Thus in *Natural Gas Pipeline* that Court limited its scope of review, "if the Commission's order, as applied to the facts before it and viewed in its entirety, produces no arbitrary result, our inquiry is at an end." *Id.*

A careful examination of the record in this case has led us to the conclusion that in the items wherein the Commonwealth Court differed from the PUC upon the questions presented to it, there was merely the substitution of the court's judgment for that of the Commission, rather than a determination that the order of the latter was unlawful.

Accordingly, we reverse the order of the Commonwealth Court below, and reinstate the order of the Public Utility Commission.

2. The Appeal at No. 278 January Term, 1978

As the preceding discussion has totally undercut the legal foundation for the Commonwealth Court's decision in this case, we reverse that court's order entered below. Based on our analysis of the arguments presented to this Court on the merits of the rate increase, we find that the order of the PUC is supported in law and by sufficient facts. Accordingly, we reinstate the order of the PUC entered below.

The orders of the Commonwealth Court are reversed and the orders of the Public Utility Commission are reinstated.

Justice Manderino did not participate in the decision of this case.

Mr. Justice Roberts joins the majority and filed a concurring opinion.

Mr. Justice Larsen joins the majority and filed a concurring opinion.

SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

No. 35 May Term, 1978

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PENNSYLVANIA GAS AND WATER COMPANY
CITY OF SCRANTON, et al

v.

PENNSYLVANIA GAS AND WATER COMPANY

APPEAL OF: PENNSYLVANIA PUBLIC UTILITY COMMISSION

Judgment

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the orders of the Commonwealth Court of Pennsylvania are reversed and the orders of the Public Utility Commission are reinstated.

/s/ MILDRED E. WILLIAMSON
Deputy Prothonotary

Dated: February 1, 1980

IN THE
SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

NO. 35 MAY TERM, 1978

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

v.

PENNSYLVANIA GAS AND WATER COMPANY
(WATER DIVISION)

CITY OF SCRANTON ET AL.

v.

PENNSYLVANIA GAS AND WATER COMPANY
(WATER DIVISION)

Appeal from order of the Commonwealth Court of Pennsylvania, dated May 27, 1975, at Nos. 1092, 1122, & 1123 C. D. 1974, Reversing in part the order of the Pennsylvania Public Utility Commission at R. I. D. 72, dated July 9, 1974.

IN THE
SUPREME COURT OF PENNSYLVANIA
EASTERN DISTRICT

No. 278 January Term, 1978

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

v.

PENNSYLVANIA GAS AND WATER COMPANY
(WATER DIVISION)

OFFICE OF CONSUMER ADVOCATE and
PENNSYLVANIA ATTORNEY GENERAL,
Intervenors

Appeal from order of the Commonwealth Court of Pennsylvania, dated December 21, 1977, at No. 1523 C. D. 1976, Reversing the order of the Pennsylvania Public Utility Commission at R. I. D. 209, dated August 4, 1976.

Concurring Opinion
Filed February 1, 1980

ROBERTS, *J.*

The PUC is statutorily and constitutionally obliged to set "just and reasonable" rates and may, but is not required to, use cost of reproduction in the rate base. See *Keystone Water Co. v. Pennsylvania Public Utility Commission*, 477 Pa. 594, 615-26, 385 A. 2d 946, 957-63 (1978) (Opinion of Roberts, J., in Support of Reversal, joined by Eagen, C.J. & Nix, J.). I join the majority opinion which is in accord with the views expressed in the Opinion in Support of Reversal in *Keystone Water*, and I agree with the majority that the orders of the Commonwealth Court should be reversed and the orders of the PUC reinstated.

IN THE
SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT AND EASTERN DISTRICT

No. 35 MAY TERM, 1978

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

v.

PENNSYLVANIA GAS AND WATER COMPANY,
(WATER DIVISION),
Appellee

CITY OF SCRANTON, et al.

v.

PENNSYLVANIA GAS AND WATER COMPANY
(WATER DIVISION)

Appeal from Order of the Commonwealth Court of Pennsylvania, Dated May 27, 1975, at Nos. 1092, 1122, 1123 C. D. 1974, Reversing in Part of the Order of the Pennsylvania Public Utility Commission at R. I. D. 72, Dated July 9, 1974.

No. 278 JANUARY TERM, 1978

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

v.

PENNSYLVANIA GAS AND WATER COMPANY—
WATER DIVISION,
Appellee

OFFICE OF CONSUMER ADVOCATE

and

PENNSYLVANIA ATTORNEY GENERAL,

Intervenors

Appeal from the Order of the Commonwealth Court Dated December 21, 1977 at No. 1523 Commonwealth Docket 1976 Reversing the Order of the Pennsylvania Public Utility Commission at Rate Investigation Docket No. 209, Dated August 4, 1976.

Concurring Opinion

Filed February 1, 1980

JUSTICE ROLF LARSEN

I join in the majority opinion. Additionally, I would add that under no circumstances can a "windfall" or gift to a utility be included in a rate base.

APPENDIX B.

[Letterhead of]

SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

CARL RICE, ESQ.
PROTHONOTARY
MILDRED E. WILLIAMSON
DEPUTY PROTHONOTARY

434 Main Capitol Building
P. O. Box 624
Harrisburg, Pennsylvania 17108
(717) 787-6181

February 24, 1981

Charles E. Thomas,
Esquire
P. O. Box 999
Harrisburg, Pa. 17108

Augustine A. Mazzei, Jr.,
Esquire
420 Boulevard of the Allies
Pittsburgh, Pa. 15219

Re: Pa. Gas & Water, etc. v. Pa. Public Utility Comm., etc. No. 35 May Term, 1978 (J. 237/79)

Dear Mr. Thomas & Mr. Massei:

This is to advise you that the Applications for Reargument on behalf of Pa. Gas and Water Company and Equitable Gas Company have been denied.

Very truly yours,

/s/ MILDRED E. WILLIAMSON
Deputy Prothonotary

MEW/sb

cc: D. Mark Thomas, Esquire
Patricia Armstrong, Esquire
West Publishing Company
Joseph J. Malatesta, Jr., Esquire

[Note: The Prothonotary has advised that the Applications for Reargument were denied on February 18, 1981 and that the denial was endorsed by the court below upon the cover of the application, but no order was issued.]

APPENDIX C.

IN THE
COMMONWEALTH COURT OF PENNSYLVANIA

No. 1095 C. D. 1974

PENNSYLVANIA PUBLIC UTILITY COMMISSION OF THE COMMONWEALTH OF PENNSYLVANIA,
Appellee

v.

PENNSYLVANIA GAS AND WATER COMPANY (WATER DIVISION),
Appellant

No. 1122 C. D. 1974

COMMONWEALTH OF PENNSYLVANIA, PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee

v.

CITY OF SCRANTON,
Appellant

PENNSYLVANIA GAS & WATER CO.,
Intervening Appellee

CARBONDALE AREA SCHOOL DISTRICT,
Intervening Appellant

No. 1123 C. D. 1974

COMMONWEALTH OF PENNSYLVANIA,
PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee

v.

COUNTY OF LACKAWANNA,
Appellant

PENNSYLVANIA GAS & WATER CO.,
Intervening Appellee

CARBONDALE AREA SCHOOL DISTRICT,
Intervening Appellant

BEFORE:

HONORABLE JAMES S. BOWMAN, President Judge
HONORABLE JAMES C. CRUMLISH, JR., Judge
HONORABLE HARRY A. KRAMER, Judge
HONORABLE ROY WILKINSON, JR., Judge
HONORABLE GLENN E. MENCER, Judge
HONORABLE THEODORE O. ROGERS, Judge
HONORABLE GENEVIEVE BLATT, Judge

Argued: February 3, 1975

Opinion

OPINION BY JUDGE KRAMER FILED: May 27, 1975

This opinion involves three appeals taken from a long-form order, dated July 9, 1974, issued by the Pennsylvania Public Utility Commission (PUC). The PUC order is typical of the extensive, complicated, and technical adjudication usually involved in a public utility rate case.

The pertinent procedural and factual aspects of the case, together with the parties involved in this appeal, will be described hereinafter.

The public utility involved is the Pennsylvania Gas and Water Company (PG&W). It is a combination public utility [1] rendering both natural gas service and water service. At the end of the test year, September 30, 1972, it rendered public utility water service to 145,726 consuming units, in a 165 square mile area, stretching from Forest City in Susquehanna County on the north, to Glen Lyon in Luzerne County 70 miles to the south. Its water service area includes 60 municipalities, including Scranton and Wilkes-Barre. Its service area is divided into two divisions, viz., Spring Brook Division and Scranton Division, which, for all practical purposes, are not interconnected. It supplies water service from over 60 reservoirs and various water wells situated in mountainous regions, and operates for the most part on a gravity-flow basis, with a storage capacity of over 21 billion gallons. PG&W transmits its water through 1,600 miles of water mains.

This case had its beginning on January 30, 1973, when PG&W filed various supplements to its tariffs under which it proposed to increase its water rates so as to produce a total annual increase in revenue of $4,870,103, or approximately a 50 percent increase over the then existing rates, exclusive of the state tax adjustment surcharge.[2] All

1. PG&W is a combination public utility in that it renders natural gas service as well as water service. No issues have been raised concerning the allocation of costs or expenses incurred in this joint operation.

2. The following chart shows the pertinent detail on the various supplements:

PG&W Tariff Water—Pa. P. U. C. No. 3 (Spring Brook Division)
Supp. No. 8—increase $1,299,949—collected from 4/12/73
Supp. No. 9— " $1,559,939—not collected

of the filed supplements were to become effective April 1, 1973, but they were subsequently and voluntarily postponed, to become effective April 12, 1973. The increased rates were to affect all of its customers, except municipalities and public fire-protection consuming units. Some of the supplements, calculated to produce $2,213,683 of additional revenue, were permitted to become effective April 12, 1973. The remainder of the supplements were suspended by the PUC for the full statutory suspension periods of nine months, to January 12, 1974. PG&W *voluntraily* extended the suspension period to March 15, 1974. On March 14, 1974, the PUC fixed the then effective rates of that date as temporary rates, until final order.

Twenty-three formal complaints were filed, all of which were consolidated for the purposes of the hearings. Three of the complaints were withdrawn or dismissed. From a reading of the record we can state that in reality only the City of Scranton and the County of Lackawanna (hereinafter referred to as complainants) actively participated at the hearings. After 13 days of hearings (over 1,300 pages of testimony and 32 exhibits), the PUC issued its long-form order from which came these appeals.

In its adjudication, the PUC found a fair value of $102,000,000 and a fair rate of return of 7.35 percent, thus providing income available for return in the amount of $7,497,000. This return, together with the PUC's findings on operating expenses, depreciation, taxes, and other adjustments set forth in the adjudication, led the PUC to

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2. (Cont'd.)

PG&W Tariff Water—Pa. P. U. C. No. 4 (Scranton Division)

Supp. No. 9—	increase $ 913,734	—collected from 4/12/73
Supp. No. 10—	" $1,096,481	—not collected

There was another supplement to Tariff Water—Pa. No. 5 which in effect transferred service thereunder to Tariff Water—Pa. P. U. C. No. 4 (Scranton Division)

conclude that the allowable annual revenues were $13,491,929, or $628,318 less than the total revenues sought by PG&W in its filings of the various supplements to its tariff mentioned above.

PG&W, the City of Scranton and the County of Lackawanna filed separate appeals to this Court. PG&W filed a petition to intervene in the appeals of the City and the County which was granted by this Court, after which all of the appeals were consolidated for disposition. On September 11, 1974, the Carbondale Area School District filed a petition to intervene, which was granted on that same date. However, PG&W filed a motion to quash the intervention by the school district as an appellant for the reason that the school district had not filed a timely appeal. Argument on the motion to quash was listed at the consolidated argument. Preliminarily, we will dispose of the motion to quash by stating that a party to an administrative proceeding with the right to appeal may not utilize a petition to intervene to obviate the statutory time limit on appeal, and this Court is powerless to extend the mandatory statutory appeal provisions. *See Pittsburgh v. Pennsylvania Public Utility Commission and Duquesne Light Company*, 3 Pa. Commonwealth Ct. 546, 284 A. 2d 808 (1971) and *Smith v. Pennsylvania Public Utility Commission*, 174 Pa. Superior Ct. 252, 101 A. 2d 435 (1953). Therefore, we must grant the motion to quash.

Because these three appeals have been consolidated, we will deal with each of the issues raised in the various appeals under appropriate subtitles hereinafter.

Our scope of review is limited by statute. In section 1107 of the Public Utility Law (Act), Act of May 28, 1937, P. L. 1053, *as amended*, 66 P. S. § 1437, we find:

> "The order of the commission shall not be vacated or set aside, either in whole or in part, except for error of law or lack of evidence to support the findings, de-

termination, or order of the commission, or violation of constitutional rights."

We have stated in a recent opinion that this section of the statute means that the appellate courts cannot conceive an independent judgment from the record, and substitute it for the judgment of the PUC. We may not indulge in the process of weighing evidence and resolving conflicts in testimony. The PUC's discretionary findings and conclusions must be accepted unless they are totally without support in the record, are based on error of law, or are unconstitutional. *See Lower Paxton Township v. Commonwealth of Pennsylvania, Public Utility Commission,* 13 Pa. Commonwealth Ct. 135, 317 A. 2d 917 (1974) and *Johnstown-Pittsburgh Express, Inc. v. Public Utility Commission,* 5 Pa. Commonwealth Ct. 521, 291 A. 2d 545 (1972). With these guidelines in mind, we now turn to the specific issues raised in these three appeals.

I. Rate Base Exclusion

To understand the issue involved here, it is necessary to set forth some pertinent facts. At some time prior to 1969 the Commonwealth of Pennsylvania, acting through its Department of Highways (now known as the Pennsylvania Department of Transportation and hereinafter referred to as PennDOT), proposed to construct portions of Interstate Route 81-E and Interstate Route 84 through a portion of PG&W's service area, rendering "useless" one of PG&W's reservoirs and the Roaring Brook watershed. The proposed action directly affected approximately 13 square miles of watershed used to deliver water to PG&W's customers. The effect of PennDot's construction would have destroyed, for all practical purposes, the water supply then existing for the City of Scranton. As a result of

years of negotiations between PennDOT and PG&W, on October 21, 1969, they entered into an agreement setting forth a compromise on the reimbursement by PennDOT to PG&W for the expected damages to its water supply system. Under this agreement PG&W was paid $2,754,-753.56. The determination of the damages paid was based upon what is known as a "cost-to-cure" method, i.e., the estimated cost to replace the company's water supply facilities rendered useless as a result of the proposed highway construction. The agreement specifically set forth that $1,703,103.56 represented the cost of the construction of pipeline facilities and $1,051,650 for the cost of construction of a new dam and reservoir to substitute and replace the facilities taken by the proposed highway construction. The record indicates that PG&W constructed 32,000 feet of 30-inch pipeline, and a 1.3 billion gallon capacity reservoir, and that these new facilities created additional supply capacity over and above the capacity of the facilities actually rendered useless by the PennDOT construction. PG&W invested an additional $243,202 in the pipeline construction, and $4,122,290 additional funds for the new reservoir. In other words, PG&W used all of the monies paid under the agreement by PennDOT for new facilities, and as a result of the entire transaction, spent substantial additional sums.

Based generally upon equitable principles, the PUC termed the payment by PennDOT as a contribution or "contributed property" and concluded that it would disallow from the original cost measure of value $2,558,634, which is the amount deemed to be the net figure, after deducting PG&W's unrecovered investment in plant resulting from the transaction. The end results of this deduction from the rate base were (1) that PG&W was not permitted to earn anything on the dollars of investment in plant, used and useful in the public service, which the

PUC characterized as having been "contributed" by PennDOT; and (2) the incomprehensible inclusion in the rate base of $196,120, representing the unrecovered investment in plant no longer in service. Annual depreciation allowance was likewise affected.

PG&W, in its appeal to this Court, contends that the PUC erred in excluding this investment in plant from both the company's original cost measure of value and the fair value determination, and in ordering such part-payment of PennDOT to be accounted for as contribution in aid of construction for accounting and rate-making purposes.

This very same issue was presented to this Court in *Keystone Water Company, White Deer District v. Pennsylvania Public Utility Commission*, 19 Pa. Commonwealth Ct. 292, 339 A. 2d 873 (No. 633 C. D. 1974, filed May 27, 1975), the opinion for which is filed simultaneously herewith. In *Keystone* the sole issue was whether the PUC could exclude from the rate base monies paid by PennDOT as damages for the taking of part of the property of a public utility when the monies received were reinvested in plant used and useful in the public service. We there held that it was error for the PUC to exclude such plant from the rate base. Everything we said there is equally applicable here, and there is no need to repeat the principles upon which we based our holding. If there is any distinction between *Keystone* and this case, it is that this case is stronger since here PG&W was forced to secure a new source of water supply and expend considerable sums of money, in addition to the payment made by PennDOT, to provide an equivalent or better source of supply and facilities for service to its customers. Once again, referring to the principles we set forth in *Keystone*, we summarize our disposition of this issue by stating (1) that the agreement between PennDOT and PG&W dated October 21, 1969, was legally the payment of damages for

property taken by PennDOT, even though the determination of those damages was based upon a cost-to-cure basis; (2) that the damages paid under that agreement and the facilities built therewith are solely the property of the stockholders of PG&W in which neither the public nor PG&W's customers have any property interest; (3) that for rate case purposes the source of the funds utilized in the construction or purchase of plant devoted to the public service of a public utility is irrelevant, unless such monies are purely donations, contributions in aid of construction, or customers' advances for construction (which the monies herein question are not); (4) that plant used in the public service by a public utility obtained and financed by damage payments for property taken to permit highway construction must be included in the rate base; (5) that annual depreciation must be allowed on such plant; and (6) that under the facts of this case and the facts of *Keystone* and the provisions of the uniform system of accounts for water utilities, the amount of money received as damages by PG&W from PennDOT in excess of the dollars representing the undepreciated property actually taken should be accounted for by PG&W in account 401 entitled "Miscellaneous Credits to Surplus". For a complete understanding of our holding on this issue, the reader is referred to our opinion in *Keystone, supra.* As a result of our holdings, this matter must be remanded to the PUC for a redetermination of the rate base so as to include the $2,558,634 in original cost and determine the effect of its inclusion on any other measures of value utilized by the PUC in determining fair value. In addition the PUC's allowance for annual depreciation will have to be increased accordingly.

At this point we should mention that the complainants mistakenly contend, in an issue arising from the fair value determination of the PUC, that somehow the PUC failed

to exclude this PennDOT payment from its determination of fair value. Our careful reading of the PUC's adjudication permits us to conclude that the PUC did exclude the PennDOT payment from all measures of value, including fair value.

II. Fair Value

PG&W presented evidence that its total net original cost for both divisions amounted to $68,288,857. The PUC accepted this evidence, with the exception of the so-called "contributed property" mentioned above. On the basis of the average of measures of value at depreciated original cost, and trended original cost depreciated at five-year average prices, PG&W contended that the fair value of its plant should be $123,184,391 and, in addition, based upon its claim for an increase in value based upon the current inflation, it contended that a fair value of $130,000,000 would be more realistic. Complainants contended that the maximum fair value should be $91,900,000, and their contention was based upon a weighting of original cost and trended original cost at five-year average prices, based upon the capital structure ratios of PG&W. After discussing at great length the evidence produced and properly noting that there was no set formula, to which it was bound, the PUC set a fair value as of September 30, 1972, at $102,000,000.

PG&W contends that the fair value set by the PUC is so low as to constitute a manifest abuse of discretion. It attempted to prove its point by referring back to a finding of the PUC on the rate base in a prior case (in 1959) involving PG&W, and then adding only the increase in original cost (not fair value) to the finding of fair value in the prior case. From this illustration, PG&W argues that fair value could not be less than $105,000,000. The problem with PG&W's argument is that the Commission's responsibility is to determine fair value as of the end of

the test period used in *this* rate case. What may have been fair value at another time is not necessarily fair value 15 years later. If PG&W had intended to use this approach to determine fair value, it should have undertaken the burden of proving that there have been no changed factual circumstances occurring subsequent to the prior finding of fair value. This PG&W did not do. *See Baltimore and Ohio Railroad Company v. Pennsylvania Public Utility Commission*, 135 Pa. Superior Ct. 20, 24, 4 A. 2d 628, 630 (1938) and *Cheltenham & Abington Sewerage Company v. Public Service Commission*, 122 Pa. Superior Ct. 252, 264-65, 186 A. 149, 156 (1936). There is evidence in the record that costs, generally, rose materially since the test year in the prior case, but all of those factors were taken into account in the trending processes used by the PUC, and all of the parties to this case, and, therefore, PG&W's contention in this regard is without merit.

PG&W next contends that the weight to be given trended original cost in the finding of fair value by the PUC was in error. On the subject of weighting, our courts have said many times that there is no particular formula which can be applied to determine fair value. In *Duquesne Light Company v. Pennsylvania Public Utility Commission*, 176 Pa. Superior Ct. 568, 580-81, 107 A. 2d 745, 750-51 (1954), our Superior Court stated:

> "Essentially, it would appear that the question involved here is one of the weight to be given the trended cost evidence. Such evidence is merely a guide in the determination of fair value. It cannot be seriously contended that even under the best of conditions it is free from error, and the fact that it does contain defects would not justify the Commission in rejecting it. So long as the evidence is reasonably accurate, the weight to be given it is a matter for the Commission."

In *Pittsburgh v. Pennsylvania Public Utility Commission*, 187 Pa. Superior Ct. 341, 350-51, 144 A. 2d 648, 654 (1958), the Court said:

> "The apparent purpose of the requirement that the commission exercise its judgment upon all the relevant facts and not confine itself to any one particular measure of value is to arrive at a rate base which is fair to both the utility and to the customer. . . . To be fair to both the utility and the customer generally requires that the commission reject as the predominant measure of value any particular measure which would be unreasonably advantageous to one at the expense of the other of the component interests which the commission is required to keep in balance in the public interest." (Citation omitted.)

PG&W argues that there is support in the law, and from prior adjudications of the Commission, for the establishment of fair value at a point near the average of a depreciated original cost and depreciated trended original cost at five-year average prices. In *Johnstown v. Pennsylvania Public Utility Commission*, 184 Pa. Superior Ct. 56, 66, 133 A. 2d 246, 251 (1957), our Superior Court observed that ". . . without approving any formula . . . the commission has been inclined to establish a definite finding of fair value, when one is made, at a point near the average of original cost depreciated and a reproduction cost depreciated." If the PUC had applied such a formula to the statistics in this case, there is no question but that fair value would have been set at something in excess of $102,000,000. The fair value found by the PUC ($102,000,000) is approximately 84 percent of the amount determined by the averaging method which apparently has been used by the PUC in at least 12 major water utility rate adjudications since 1971. This is one

of those areas in which our scope of review restrains us from substituting our judgment for that of the PUC. While our review of this record would lead us to believe that the fair value found by the PUC is low when compared with what it found as fair value in other cases, a fair value which is approximately 150 percent of the net original cost as found by the PUC, cannot be said to be an abuse of discretion *per se*.

The complainants in their appeals raise additional issues relating to fair value. They contend that (1) the PUC failed to take into account labor productivity growth, which they claim is applicable to each and any year of construction; and (2) the PUC erred in not making sufficient or adequate findings of fact from which they (complainants) could determine the exact weight which the Commission applied to the original cost figures and to the trended original cost figures.

The PUC rejected the complainants' contention on productivity growth by observing that the trending statistics used reflected to some extent increased productivity by labor through the use of machines. The PUC also questioned the credibility of complainants' witness. Our review of the record permits us to conclude that the PUC did not abuse its discretion in its consideration of productivity growth.

With regard to the weight to be given to the various factors utilized in arriving at a fair value, the law is quite clear that there is no magical formula. Section 311 of the Act, 66 P. S. § 1151, (Supp. 1974-1975), states in pertinent part:

> "The commission may, after reasonable notice and hearing, ascertain and fix the fair value of the whole or any part of the property of any public utility, in so far as the same is material to the exercise of the jurisdiction of the Commission. . . ."

The PUC is given some direction in section 1005 of the Act, 66 P. S. § 1395, which provides:

> "After the conclusion of the hearing, the commission shall make and file its findings and order with its opinion, if any. Its findings shall be in sufficient detail to enable *the court on appeal,* to determine the controverted question presented by the proceeding, and whether proper weight was given to the evidence. . . ." (Emphasis added.)

The fair value figure represents a judgment to be made by the PUC within its discretion, and there is no magical mathematical formula to which the PUC is bound in determining fair value. *See Pittsburgh v. Pennsylvania Public Utility Commission, supra; Equitable Gas Company v. Pennsylvania Public Utility Commission,* 160 Pa. Superior Ct., 458, 51 A. 2d 497 (1947). The PUC must consider all relevant elements and factors having a bearing on fair value, including original costs and trended original cost. *Pittsburgh v. Pennsylvania Public Utility Commission, supra; Equitable Gas Company v. Pennsylvania Public Utility Commission, supra.* In *Pittsburgh v. Pennsylvania Public Utility Commission,* 171 Pa. Superior Ct. 187, 195, 90 A. 2d 607, 612 (1952), our Superior Court stated:

> "The weight to be given any particular measure of value, such as original cost or reproduction cost [trended original cost], is for the Commission, but its action must be within the area of its administrative discretion and supported by the evidence.

Historically, and as approved by the Superior Court when it had jurisdiction to review utility rate adjudications, the PUC set and approved determinations of fair value at a point near the average of the original cost de-

preciated and the trended original cost depreciated. *See Johnstown v. Pennsylvania Public Utility Commission, supra; Pittsburgh v. Pennsylvania Public Utility Commission,* 174 Pa. Superior Ct. 363, 366, 101 A. 2d 761, 763 (1954); *Orlosky v. Pennsylvania Public Utility Commission,* 171 Pa. Superior Ct. 409, 413, 89 A. 2d 903, 906 (1952).

In this case PG&W submitted as evidence the following measures of value: (1) an original cost depreciated measure of value of $68, 288, 857 as of September 30, 1972 (the end of the test period); (2) a trended original cost depreciated measure of value at December 31, 1971 prices of $205,513,456; (3) a three-year average trended original cost depreciated measure of value of $186,789,909; (4) a five-year average trended original cost depreciated measure of value of $178,079,925; and (5) a bringdown fair value of $104,913,694. The complainants presented evidence which, after deducting the approximately two and a half million dollar payment by PennDOT mentioned above from the net original cost figures, indicated (1) a December 31, 1971 price level of $170,757,517; (2) a three-year average price level (ending December 31, 1971) of $156,487,514; and (3) a five-year average price level (ending December 31, 1971) of $150,127,913. Our reading of the record permits us to summarize all of this by stating that PG&W contended that the fair value could not be less than $123,000,000 and, after giving effect to inflation, $130,000,000, while the complainants argued that the fair value could not be more than $91,900,000. In its adjudication, the PUC outlined all of the evidence presented and concluded that, based upon all the credible evidence, the fair value should be $102,000,000. Complainants contend that the PUC is required to set forth specifically the weight which it gave to the various valuation factors.

The complainants state that the capital structure of the company should be utilized in determining the weight to be given the various elements considered in arriving at fair value. They argue that since the preferred stockholders and investors in the debt of the company have their return fixed by contract, only the common stockholders need to be considered in providing sufficient earnings for the company. As a result, they applied 68.3 percent (the percentage of the total capital structure represented by debt, capital and preferred stock) to the net original cost valuation, and the remaining 31.7 percent to the five-year trended original cost figure. Through this method, the complainants arrived at a fair value of $91,900,000. While the complainants' argument has an appealing ring to it, and may have been used in other jurisdictions, the fact remains that this formula can lead to questionable results. If the PUC would adopt such a formula, what would it do with a public utility whose capital structure was 100 percent equity? If the complainants' contention is adopted, the fair value of the rate base of such a company would be set by the higher trended original cost figures. Furthermore, to be consistent, the PUC would also have to hold that the most current spot prices would have to be utilized rather than any five-year average trended price so as to adequately protect the current stockholders.

While we agree with the complainants that it would be preferable for the PUC to show in detail in its adjudication the method it used in arriving at the fair value, we believe, however, that there is sufficient detail in the adjudication in this case to permit this Court to conclude that the PUC did not abuse its discretion. There are no magical formulae which we can apply to test the reasonableness of the fair value set by the PUC. From our reading of the Act, we are certain only that the sole use of

original cost statistics or the sole use of reproduction costs statistics would violate the legislative intent. We have no doubt that the Legislature intended an averaging process somewhere between the two extremes, and, so long as the fair value set by the PUC is not below or above those two extremes, or arbitrarily set so close to either extreme that we can discern a capricious disregard of the evidence or the law, we will not interfere.

III. Fair Rate of Return

In arriving at 7.35 percent as the fair rate of return, the PUC followed the usual method of determining the actual capital structure of the company (equity, debt and preferred stock), determining the cost for each element, and then computing the weighted cost of each. In arriving at the fair rate of return, the Commission apparently used the following statistics:

Table 1

Item	*Capital Structure*	*Cost Rate*	*Weighted Cost*
Debt	57%	5.9%	3.36%
Preferred Stock	11%	4.59%	.50%
Common Equity	32%	10.90%	3.49%
Total			7.35%

A. Cost of Equity Capital

This element of the formula is the most speculative, for it is intended to be the best estimate of what investors would pay for a current issue of common stock of the public utility involved. PG&W here claimed a cost of equity in the amount of 11 percent and the complainants proposed a range from 9.7 percent to 10 percent. In *Lower Paxton*

Township, supra, we stated that the cost of capital should be based upon evidence of the company's recent past experience:

> "The cost of equity determination usually gives consideration to such matters as the demands for the use of money, the growth in earnings expected by the investor, earnings—price ratios, dividend yields, the marketing cost associated with raising common equity capital and the earnings of comparable companies with similar risks." 13 Pa. Commonwealth Ct. at 143-44, 317 A. 2d at 922.

We there noted, once again, that there is no magical formula we can utilize to test the discretion of the PUC. The PUC is required to determine the current cost for common equity in determining fair rate of return, and current earnings-price ratios are representative of such costs. *Pennsylvania Public Utility Commission v. Peoples Natural Gas Company,* 35 Pa. P. U. C. 61, 84-85 (1957). The PUC considered earnings-price ratios in this case, as well as other factors. We have read the record and conclude that there is evidence to support the Commission's use of 10.9 percent as the cost of equity capital.

B. Cost of Preferred Stock Capital

The PUC found 4.59 percent as the proper cost of PG&W's preferred stock capital for rate-making purposes. This was the actual cost after giving effect to a bond repurchase discount (without the discount, the actual cost was over 6 percent). It is interesting to note that the record reveals that the expert rate-of-return witnesses for both PG&W and the complainants adjusted this cost of preferred stock capital to reflect the estimated cost of a projected six-million dollar preferred stock issuance, which increased the cost of preferred stock from 4.59 to 5.72 per-

cent and 5.96 percent (this last percentage having been recommended by the complainants' witness). The PUC did not give any recognition to the proposed increased cost in their determination of the fair rate of return, in spite of the fact that it stated in its adjudication that ". . . this Commission has followed the policy of permitting, in the allowed rate of return, the weighting of new capital cost incurred following the end of test year, but known before the termination of the rate proceedings." While this would appear to be a reversible inconsistency which lowered the fair rate of return, in reality it was harmless error because of what the PUC did in its determination of the cost of debt capital, as follows:

C. Cost of Debt Capital

The Commission found that the cost of debt capital was 5.9 percent, after reflecting bond repurchase discounts. The expert rate of return witnesses for both PG&W and the complainants recommended an embedded cost of long-term debt at 5.82 percent and 5.86 percent respectively. While a first reading of the adjudication would seem to indicate that the PUC allowed a higher cost of debt capital than either of the experts recommended, still there is evidence in the record which would indicate that the PUC utilized the actual cost of the long-term debt as 5.97 percent, and adjusted this figure for bond repurchase discounts and arrived at a 5.9 percent judgment figure. While we might question the PUC's use of the 5.9 percent figure in the face of the recommendations found in the expert testimony, insofar as the cost of debt capital is concerned, we do not deem this to be reversible error, in light of the fact that the PUC ignored the increased cost of preferred stock (as noted above) which these same expert witnesses both estimated and took into account in their recommended figures for preferred stock capital.

A public utility is entitled to an opportunity to earn a fair rate of return. *Riverton Consolidated Water Company v. Pennsylvania Public Utility Commission,* 186 Pa. Superior Ct. 1, 140 A. 2d 114 (1958); *Pittsburgh v. Pennsylvania Public Utility Commission,* 182 Pa. Superior Ct. 376, 126 A. 2d 777 (1956). Our appellate courts have stated on many occasions that the following factors, if shown by the evidence, may be considered in determining fair rate of return: (1) the amount necessary to assure confidence in the financial structure of the company and maintain its credit standing; (2) the payment of dividends and interest; (3) the amount of the investment, the size and nature of the utility, its risks, and the circumstances attending its origin, development and operation; and (4) the financial structure, the credit standing, dividend, interest, and attendant risks, regulatory lag and wasting assets. *See Riverton Consolidated Water Company, supra; Pittsburgh v. Pennsylvania Public Utility Commission,* 182 Pa. Superior Ct. 376, 126 A. 2d 777 (1956); and *Wall v. Pennsylvania Public Utility Commission,* 182 Pa. Superior Ct. 35, 125 A. 2d 630 (1956). Although cost of capital and fair rate of return are not always synonymous, cost of capital "is certainly one of the most important bases upon which a fair rate of return is determined." *Lower Paxton Township, supra.* In *Lower Paxton Township,* we also noted that "[b]ecause of these many variables, the cost of capital is basically a matter of judgment governed by the evidence presented and the regulatory agency's expertise." 13 Pa. Commonwealth Ct. at 141, 317 A. 2d at 921. The PUC's judgment must be accepted unless without support in the record, based upon error of law or unconstitutional. *Lower Paxton Township, supra.* Our review of this entire complicated record permits us to conclude that there is sufficient substantial evidence to support the PUC's final determination pertaining to fair rate of return.

IV. Claimed Loss During Suspension

As is set forth at the beginning of this opinion, the proposed rates filed by PG&W were postponed several times, and by order dated March 14, 1974, the rates which were then in effect were prescribed as temporary rates pending the final determination of this matter. By virtue of the Commission's final adjudication, dated July 9, 1974, there was disallowed $628,318 of the $2,656,420 originally requested by PG&W and not collected under the temporary rates. In the final order PG&W was ordered to file new supplements to its tariffs containing acceptable rates to provide a total annual revenue of $13,491,929. These new rates were to become effective from July 9, 1974, or from within 30 days thereafter, at the election of PG&W. It was also ordered that the public authorities and public fire protection customers, which had not been included in the proposed increase, were to be included with the same overall percentage increase as all other customers, the increase to be effective for these customers from August 1, 1974. The Commission further permitted the filing of supplements to its tariff so as to permit a recoupment of revenues from its customers under the allowable rates for sales on and after March 15, 1974. PG&W argues that by virtue of this order it is not permitted to earn the 7.35 percent fair rate of return on its property used and useful in public service from January 30, 1973 (the date the company filed its rate increase) to March 15, 1974. In its brief, it calculated that loss to be $2,720,878, which it characterizes as a total loss resulting from regulatory lag.

Section 308 of the Act, 66 P. S. § 1148, sets forth the power of the PUC to suspend proposed rate increases. Subsection (a) states that no public utility may make any change in its rates except after 60 days' notice. Subsection (b) states:

"(b) Whenever there is filed with the commission by any public utility any tariff stating a new rate, the commission may, either upon complaint or upon its own motion, upon reasonable notice, enter upon a hearing concerning the lawfulness of such rate, and pending such hearing and the decision thereon, the commission, upon filing with such tariff and delivering to the public utility affected thereby a statement in writing of its reasons therefor, *may*, at any time before it becomes effective, suspend the operation of such rate for a period not longer than six months from the time such rate would otherwise become effective, and an additional period of not more than three months pending such decision. The rate in force when the tariff stating the new rate was filed shall continue in force during the period of suspension, unless the commission shall establish a temporary rate as authorized in section three hundred ten of this act. The commission shall consider the effect of such suspension in finally determining and prescribing the rates to be thereafter charged and collected by such public utility." (Footnote omitted.) (Emphasis added.)

Under section 310 of the Act, 66 P. S. § 1150, we find provisions whereby temporary rates fixed in accordance with the above provision shall be sufficient to provide a return of not less than 5 percent upon the original cost, less accrued depreciation of the physical property. Section 310 concludes with the following language:

"(e) Temporary rates so fixed, determined, and prescribed under this section shall be effective until the final determination of the rate proceeding, unless terminated sooner by the commission. In every proceeding in which temporary rates are fixed, deter-

mined, and prescribed under this section, the commission *shall* consider the effect of such rates in fixing, determining, and prescribing rates to be thereafter demanded or received by such public utility on final determination of the rate proceeding. If, upon final disposition of the issues involved in such proceeding, the rates as finally determined, are in excess of the rates prescribed in such temporary order, then such public utility shall be permitted to amortize and recover, by means of a temporary increase over and above the rates finally determined, such sum as shall represent the difference between the gross income obtained from the rates prescribed in such temporary order and the gross income which would have been obtained under the rates finally determined if applied *during the period such temporary order was in effect.*" (Emphasis added.)

We agree with PG&W that the PUC has a duty to make allowance for the loss suffered by a public utility whose rate requests are suspended for the full statutory period and later sustained by an adjudication. In *City of Pittsburgh v. Pennsylvania Public Utility Commission,* 171 Pa. Superior Ct. 187, 217, 90 A. 2d 607, 621 (1952), the Court stated that it is presumed that the Commission has considered the effect of the suspension and, therefore, the burden is upon the public utility to prove the contrary. PG&W has not met this burden, and, further, under the facts of this case, we cannot hold that the PUC acted in an arbitrary or capricious manner. First of all, the PUC permitted approximately one-half of the proposed rate increase to take effect at the end of the 60-day period (plus 12 days during which the effective date was voluntarily postponed). PG&W, therefore, collected half of the total increase during the entire period from April 12, 1973. Another fact which militates against PG&W's contention

is that prior to the end of the nine-month suspension period, PG&W voluntarily postponed the effective date to March 15, 1974. On that date, the then effective rates became temporary rates by order of the Commission dated March 14, 1974. We have a difficult time understanding the argument of PG&W that the PUC acted in an arbitrary manner in suspending these rates to March 15, 1974, when PG&W voluntarily permitted such suspension. In reaching the conclusion that the PUC did not abuse its discretion or commit an error of law in not permitting a recoupment for the period prior to March 15, 1974, we want to make clear that under our reading of the Act we believe it would be an error of law for the Commission to ignore or refuse to give consideration to the effect of any suspension beyond 60 days from the date of filing. However, when a public utility voluntarily permits a suspension of rates beyond the statutory power of the PUC, the PUC has permitted part of those rates to be collected during the entire period, and the PUC permits a recoupment back to the date on which it established temporary rates, no error of law has been committed. Notwithstanding this, we must point out that any failure by the PUC to recognize the effect of the suspension period not only creates the possibility of the confiscation of the utility's property, but could create a situation whereby utilities would be forced into filing rate increases on a monthly basis so as to protect their stockholders. The thought of any such happening (which is certainly conceivable in this day of the computer printout) would be contrary to what we perceive to be the legislative intent, i.e., reasonable regulation so as to protect both the public and the public utility.

V. PG&W's Right to Appeal

The PUC contends that by virtue of the fact that PG&W was disallowed only $628,318 out of a total re-

quest of $4,870,103, it should be denied its right to appeal. This argument is totally without merit, especially in view of our discussion of the important issues raised by both PG&W and the complainants in this case. The cases cited by the PUC with respect to PG&W's right to appeal are totally inapposite.

VI. Summary

In summary, we hold that the PUC committed an error of law in excluding the $2,558,643 payment for damages by PennDOT to PG&W for property taken, whether those damages were determined on the valuation of property taken before and after the condemnation, or whether determined by the "cost-to-cure" basis, where the money received was invested in plant used and useful in the public service. The PUC will be directed upon remand to include the amount it excluded from both the net original cost, valuation figures and any other trended original cost statistics needed to arrive at a fair value figure. Annual depreciation likewise will have to be adjusted to include an amount appropriate for the property which this PennDOT money purchased. Our review of this long record permits us to conclude that there is sufficient substantial evidence to support all of the Commission's findings on fair value with, of course, the exception of the PennDOT payment problem mentioned above. Likewise, there is sufficient substantial evidence to support the final determination of the Commission on rate of return. While we recognize that the PUC must give consideration to any losses incurred by the public utility during any suspension period beyond the 60-day filing period requirement, PG&W did not prove that the PUC did not give such consideration, especially in the light of the fact that the PUC suspended only part of the increased rates filed.

In closing, we should take note that under the cost of service accounting methods used by all utility regulatory bodies, any time a public utility realizes a rate increase, government itself receives an increase in tax revenues. This should not be overlooked. In this day when all citizens are feeling the terrible pinch of spiraling inflation, public utility bills seem to be increasing with each receipt of a bill for the past month's service. We believe it to be of great importance to highlight the fact that government receives a windfall from public utility rate increases through increased tax revenues. In this case, for instance, as a result of the Commission's adjudication, PG&W was entitled to file supplements to its tariff so as to permit it to recover annual operating revenues of $13,491,929. Of that amount, over $2,800,000 or about 20 percent will be paid to the federal, state, and local governments. We have included here the $373,284 for the public utility realty tax (part of which will be received by the local municipalities in the service area of PG&W) and $124,200 for capital stock tax, both of which are paid by PG&W's customers through the state tax adjustment surcharge. In reality PG&W is forced to become a tax collector for government to recover what may be deemed to be hidden taxes which the consumers do not realize they are paying. In this case, of the approximately four and a half million dollar rate increase, almost one million dollars represents increased taxes which the consumers must pay. Perhaps it is time to take another look at indirect taxation through consumers of public utilities. While some may advocate that there should be no taxes on public utilities, we take no position. That is a legislative matter entirely.

Because of the tone of the dissenting opinion of one of the PUC commissioners in this case, we feel constrained to add a few additional words on the role of the PUC Commissioners, their counsel and intervenors (or "consumer advocates").

As this opinion is written, this Court has before it several cases where government attorneys, often characterized as "consumer advocates", are opposing public utility rate increases. As we read the law, and as we have stated in another case involving another regulatory agency, any person who finds himself in a *judicial* or *quasi-judicial* position with the responsibility of passing upon the rights of fellow citizens, should be an advocate of nothing except justice. *Nationwide Mutual Insurance Company v. Commonwealth of Pennsylvania*, 15 Pa. Commonwealth Ct. 24, 42, 324 A. 2d 878, 886 (1974).

The duty of a PUC commissioner is to carry out the legislative intent, a part of which is for the PUC to establish rates which are as equally fair, just and reasonable as possible to the consumer, the public utility and the public. Any partiality by a commissioner in any direction is a violation of the law and reversible error. While the courts grant wide latitude in the area of regulatory discretion, courts may not approve any unreasonable, arbitrary or capricious acts which result in an abuse of that discretion. Counsel for the PUC has a duty to assist the PUC in carrying out its duty to comply with the legislative intent. Obviously, where there is no one representing the consumers in a given public utility rate case, what may be deemed to be an additional responsibility falls upon counsel for the PUC (and also the staff of the PUC) to make certain that the interests of the consumers are fully protected. Whether or not this can be categorized as the position of "consumer advocate" is a matter of degree, for even here, as we perceive counsel's duties, if counsel goes beyond the bounds of the legislative intent, counsel acts improperly. On appeal, counsel has a duty to represent the PUC and support its adjudication; counsel may not take an independent position. *See York v. Public Utility Commission*, 3 Pa. Commonwealth Ct. 270, 281

A. 2d 261 (1971), *aff'd.* 449 Pa. 136, 295 A. 2d 825 (1972) and *Liquor Control Board v. Kusic,* 7 Pa. Commonwealth Ct. 274, 299 A. 2d 53 (1972). There is a practical need for a "consumer's advocate" in these complicated cases, and the statute permits such intervention. Whether "consumer advocates" are specially authorized statewide (as now appears to be an accomplished fact in this state), or appear through specific intervention (as the solicitors for the complainants did in this case), their sole duty obviously is to protect the interests of the consumers or the public, and to highlight any errors made by either the PUC or the public utility, within the framework of the law. Even where "consumer advocates" intervene, counsel for the PUC has the same duty to carry out the legislative intent to equally protect the consumers, the public utility, and the public. We hope that these additional thoughts will clear the air on the various roles of the parties involved.

Order

And Now, this 27th day of May, 1975, based upon the above opinion, the motion of Pennsylvania Gas and Water Company to dismiss the petition to intervene filed by the Carbondale Area School District is hereby granted; and it is ordered that this entire matter be remanded to the Pennsylvania Public Utility Commission for the purpose of amending its adjudication dated July 9, 1974, so as to amend its rate-based calculations, both for net original cost and fair value, by including the appropriate amount of money representing the payment by the Pennsylvania Department of Transportation to Pennsylvania Gas and Water Company under the agreement dated October 21, 1969, to amend its findings with regard to annual depreciation to be allowed on the said property involved in the rate-base adjustment mentioned immediately here-

inbefore, and to make any other cost of service adjustments which may be necessary as a result thereof and not inconsistent with anything set forth in the above opinion; and it is also ordered that Pennsylvania Gas and Water Company shall be permitted to file supplements to its various tariffs affected hereby so as to recover the total amount of revenue permitted by the Pennsylvania Public Utility Commission under its adjudication dated July 9, 1974, as adjusted by virtue of this order, so that increased rates may be recovered from its customers from March 15, 1974 and to permit the collection of increased rates from the public authorities and public fire protection customers as ordered in the Pennsylvania Public Utility Commission's order of July 9, 1974; and it is further ordered that, to the extent the order of the Pennsylvania Public Utility Commission, dated July 9, 1974, is inconsistent herewith, it is reversed; and insofar as it is not inconsistent herewith, it is affirmed.

/s/ HARRY A. KRAMER
Harry A. Kramer, *Judge*

Judge Wilkinson concurs in the result only.

IN THE
COMMONWEALTH COURT OF PENNSYLVANIA

No. 1095 C. D. 1974

PENNSYLVANIA PUBLIC UTILITY COMMISSION
OF THE COMMONWEALTH OF PENNSYLVANIA,
Appellee

v.

PENNSYLVANIA GAS AND WATER COMPANY
(WATER DIVISION)
Appellant

No. 1122 C. D. 1974

COMMONWEALTH OF PENNSYLVANIA,
PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee

v.

CITY OF SCRANTON,
Appellant

PENNSYLVANIA GAS & WATER CO.,
Intervening Appellee

CARBONDALE AREA SCHOOL DISTRICT,
Intervening Appellant

No. 1123 C. D. 1974

COMMONWEALTH OF PENNSYLVANIA,
PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee

v.

COUNTY OF LACKAWANNA
Appellant

PENNSYLVANIA GAS & WATER CO.,
Intervening Appellee

CARBONDALE AREA SCHOOL DISTRICT,
Intervening Appellant

BEFORE:

HONORABLE JAMES S. BOWMAN, President Judge
HONORABLE JAMES C. CRUMLISH, JR., Judge
HONORABLE HARRY A. KRAMER, Judge
HONORABLE ROY WILKINSON, JR., Judge
HONORABLE GLENN E. MENCER, Judge
HONORABLE THEODORE O. ROGERS, Judge
HONORABLE GENEVIEVE BLATT, Judge

ARGUED: February 3, 1975

Dissenting Opinion

DISSENTING OPINION BY JUDGE BLATT

FILED: MAY 27, 1975

For the reasons set forth in my dissenting opinion in *Keystone Water Company, White Deer District v. Penn-*

sylvania Public Utility Commission, 19 Pa. Commonwealth Ct. 292, 339 A. 2d 873, (No. 633 C. D. 1974, filed May 27, 1975) I must respectfully dissent to that portion of the majority opinion which holds that the Public Utility Commission improperly excluded from the rate base that amount of the condemnation award paid by the Pennsylvania Department of Transportation, to provide that a functional substitute would be constructed to insure the continued availability of a water supply to the affected consumers of the Pennsylvania Gas and Water Company. I believe that such exclusions are both constitutional and just and reasonable under the laws of the Commonwealth.

/s/ GENEVIEVE BLATT
Genevieve Blatt, Judge

APPENDIX D.

PENNSYLVANIA PUBLIC UTILITY COMMISSION

RATE INVESTIGATION DOCKET NO. 72,
COMPLAINT DOCKET NO. 19850, ET AL.

R. I. D. 72—Pennsylvania Public Utility Commission
C. 19850 —City of Scranton
C. 19868 —County of Lackawanna
C. 19874 —Wilkes-Barre Township
C. 19891 —County of Luzerne
C. 19893 —Plains Township
C. 19894 —City of Wilkes-Barre
C. 19898 —Carbondale Area School District
C. 19904 —Ervin Hohensee and Gene Basalyga
C. 19911 —Valley View School District
C. 19912 —Borough of Olyphant
C. 19913 —Polish National Union of America
C. 19915 —Borough of Dickson City and Borough of Throop
C. 19918 —Borough of Jermyn
C. 19920 —Borough of Blakely
C. 19921 —Borough of Moosic
C. 19922 —Borough of Jessup
C. 19924 —Borough of Dunmore
C. 19942 —Sandvik Steel, Inc.
C. 19954 —Borough of Archbald
C. 19970 —Jaunty Fabric Corporation

v.

Pennsylvania Gas and Water Company
(Water Division)

July 9, 1974

[EXCERPT]

Contributed Property

On October 21, 1969, the Commonwealth of Pennsylvania, acting through the Department of Highways (now the Department of Transportation) and respondent entered into an agreement which resulted in a payment of $2,754,753.56 by the Commonwealth to respondent. The payment was for construction of plant to replace the existing Dunmore No. 7 Reservoir and Nay Aug Well System, located at the Dunmore No. 7 Reservoir, all within respondent's Roaring Brook watershed area.

The proper treatment of this payment, for public utility accounting and rate making purposes, is one of the principal issues in these proceedings. Respondent contends it should be included in its claimed measures of value. Complainants consider the payment as one in the nature of a contribution in aid of construction and contend it should be excluded from measures of value.

The full agreement has been made a part of this record. The purpose of the agreement and other pertinent facts are here quoted directly from the agreement, as follows:

> "WHEREAS, Commonwealth proposes to undertake, by contract, with Federal-aid participation, the construction and improvement of Sections 10, 12, 13 and 14 of Legislative Route 1002, as part of Interstate Route 81-E, and of Sections 1A, 1B, 1C, and 2 of Legislative Route 1012, as part of Interstate Route 84, within the Roaring Brook watershed area of Lackawanna and Wayne Counties, Pennsylvania . . . , and
>
> "WHEREAS, Company owns and operates certain water supply facilities which include a dam and reservoir, known as Reservoir No. 7, within the said Roaring Brook watershed area, the water supply for which may be affected adversely by the aforesaid State highway construction and improvement project, in

that the turbidity and impurity of the water derived from the springs and tributary streams of the affected watershed area may be increased to the extent that their use as a source of water supply for public consumers would be impaired; and

"WHEREAS, to best minimize and remedy the anticipated adverse effect of the said construction and improvement project on the turbidity and purity of the water derived from the said watershed area, it has been determined that the Company will have to:

"(A) Replace its said Dam and Reservoir No. 7 through the construction and operation of a new dam and reservoir at Hollister, Covington Township, Lackawanna County, Pennsylvania . . . ;

"(B) Construct a thirty (30") inch pipeline from the Company's present Elmhurst Dam and Reservoir, in Roaring Brook Township, Lackawanna County, Pennsylvania, for a distance of approximately thirty-two thousand (32,000) feet to a certain point beyond the said Dam and Reservoir No. 7, as generally shown on Exhibit "S", so that the effluent from Company's said Elmhurst Dam and Reservoir will be protected from increased turbidity and impurity anticipated to result from the construction and maintenance of the proposed State highway construction and improvement project;"

The agreement further states:

"WHEREAS, in order to facilitate and expedite the commencement of the proposed State highway construction and improvement project, Commonwealth is willing to . . . :

"(C) under certain conditions, hereinafter set forth, assist the Company financially in making provisions for adequate protection of its water supply system by *contributing the sum of Two Million Seven Hundred Fifty-four Thousand Seven Hundred Fifty-three and 56/100 ($2,754,753.56) Dollars toward the Construction of the New Dam and Reservoir and the thirty (30") inch pipe line.*" (Emphasis added)

The agreement also sets forth that the total payment of $2,754,753.56 is comprised of $1,703,103.56, the total agreed upon contribution toward the cost of construction of the pipeline facilities, and $1,051,650.00, the total agreed upon contribution toward the cost of construction of the new dam and reservoir as a substitute and replacement facility for the existing dam and Reservoir No. 7.

From the record, it was the purpose and intent of the parties to the agreement to anticipate any potentially adverse effects from the proposed highway construction and to preclude or forestall them. Accordingly, the agreement was concluded before the commencement of the highway construction; and, before highway construction began, new facilities were constructed, per the agreement, to replace the former facilities. This was done before there were any adverse effects on the turbidity and purity of the water. As a result of the corrective measures taken in anticipation of the highway construction, service deficiencies were precluded. The Roaring Brook water supply was at all times fully available for use, without significant adverse effects, before, during and after the highway construction. Respondent showed no loss of revenues nor any other adverse effects as a result of the highway construction.

Respondent accepted the agreement costs of $1,703,103.56 for the 30-inch pipeline and $1,051,650.00 for the replacement of capacity of the replaced reservoir. We find that it was unnecessary for respondent to have expended any of its own funds for the adjustment of facilities to assure a continued potable water supply source. Any excess of funds expended in this transaction by respondent over the agreement payment apparently was for the additional capacity of water impounded by the Hollister Dam and Reservoir which respondent chose to build instead of a reservoir with the same capacity as Dunmore No. 7.

It is contended by respondent that the aforesaid agreement payment was not a donation or contribution, but on the contrary, was compensation for damages, and therefore, should not be credited to Account No. 265, CONTRIBUTIONS IN AID OF CONSTRUCTION, but instead should be credited to the earned surplus account with concurrent charges to the fixed capital and depreciation reserve accounts for the retirement of the property replaced. Respondent further contends that it should be permitted to earn a return on *all* of the property financed by the $2,754,753.56 payment received from the Commonwealth. At present, the agreement payment is reflected by respondent in Account No. 242, Other Deferred Credits.

Complainants contend that respondent has unduly complicated the issue and that the language of the agreement is clear wherein the agreement provides that the Commonwealth:

> "is willing to . . . assist the company financially in making provisions for adequate protection of its water supply system by contributing $2,754,753.56 toward the construction of the New Dam and Reservoir and the thirty (30") inch pipeline."

Complainants contend that respondent has accepted a contribution from the Commonwealth to build certain specific plant; and since such capital was not supplied by the investors, the payment should be excluded from rate base after allowance for the unrecovered portion of original cost of the facilities that were replaced as a result of the agreement. By this treatment, for public utility accounting and rate making purposes, neither the respondent nor the rate payers will have suffered any adverse effects as a result of the highway construction and the agreement related thereto.

It should be noted that respondent's valuation engineer in his studies of this project labeled the Dunmore No. 7 Reservoir and Nay Aug Well System *as plant held for future use.* This classification, *rather than a retirement of plant,* was made when he transferred this plant from used and useful property as a result of the replacement by facilities paid for by the Commonwealth contribution. This Commission's order of December 1, 1969, relating to the approval of the aforesaid agreement at A. 95621, stated that the damage to the watershed, while not permanent, may be over 15 years duration. The record indicates that the replaced facilities have not been physically removed. This is an indication that respondent may in the future reinstate these properties to a used and useful status to the benefit of the stockholders.

A prime purpose and intention of the parties to the October 21, 1969 agreement was to anticipate and eliminate, preclude or neutralize any potentially adverse effects of highway construction on the public utility service being furnished by respondent. This was accomplished. Because of the construction of the pipeline facility and the new dam and reservoir neither respondent's ability to serve nor respondent's potable water supply was adversely effected by the highway construction, and respondent's fi-

nancial standing was in no way impaired thereby. As a result of the entire transaction, respondent was left with equivalent or better facilities than it had had prior thereto, at no cost to respondent's stockholders. The problem is how this $2,754,753.56 shall be treated for public utility accounting and rate making purposes under the aforesaid facts and circumstances.

For public utility accounting and rate making purposes we must reject respondent's contention. Property, which is used or useful in rendering a public utility service and which has been a part of a public utility's rate base is dedicated to a public use, and is impressed with a public trust. It (or the proceeds or accruals therefrom) is subject to regulation by the properly designated regulatory body and remains subject to that regulation until such time as that regulatory body duly finds it in the public interest to approve its release from public service. Such property must be regulated in the interest of the public no less than in the interest of the utility. Equities must be balanced and justice must be done to all concerned. Accordingly, when a utility suffers extraordinary losses in service value of utility property abandoned or otherwise retired from service, or suffers unforeseen damages to property which damages could not reasonably be anticipated, and where the utility has not otherwise recovered its investment, this Commission can and, where equities require, does permit the utility to recover from the ratepayers, as a proper and necessary expense of rendering the public service, the necessary amount to make the utility whole. On the other hand, where, as here, the utility recovers an amount or sum as a result of compensation for particular property and the potential consequential injury to the service of the ratepayers for whom that property was dedicated to the public use, the Commission, where the equities dictate, may require that amount received by

the utility to be treated, for public utility accounting and rate making purposes, in such manner as will place the utility and the ratepayers in the same position, insofar as reasonably possible, as they were before the extraordinary event or transaction which gave rise to the sum or amount in question.

For rate making purposes, we cannot permit respondent to receive all the salutary effects of the agreement and pass them on to the stockholders as a windfall while passing on to the ratepayers only the increased rates that would become necessary had there been no agreement and contribution. Clearly, the payment in question resulted and stemmed from consideration of the property's dedication to public use as a water utility, and recognition of the potential injury to the interests and service of the water utility customers. In situations and circumstances such as this, the customers of a utility are in the nature of third party beneficiaries whose interest in the utility service must be protected. The essence of public utility regulation is the protection of the public and the assurance of adequate service to them at reasonable rates on the one hand, and, on the other, a fair opportunity to the utility to secure a reasonable rate and no windfall from such services. To reflect equitably and meaningfully the near restoration of, or equitable substitution for, the pre-agreement status quo, both the utility and its customers must be made whole insofar as reasonably possible. This we shall do. *As a result of our treatment of the highway transaction, the customer's rates remain unchanged by the highway transaction and respondent's financial status and stability and its ability to serve also remain unchanged.*

It should be further noted that this Commission, as a matter of longstanding policy, has consistently deducted recorded contributions in aid of construction and customer's advances for construction from all measures of

value in determining rate base; and respondent, in these proceedings and heretofore, has eliminated these items as recorded on its books from the claimed measures of value. Similarly, the Commonwealth's payment at issue herein must be deducted from all measures of value at a net amount after giving consideration to respondent's unrecovered balance of the plant replaced. We find this reasonable and necessary, *inter alia*, for the following reasons: (1) the stockholders would otherwise benefit unjustly and unnecessarily at the expense of the customers, (2) the funds were not provided by respondent and respondent is not injured, (3) governmental funds were used, indicating a compound of payments by the customers, (4) respondent has not suffered any loss of income through interruption of service by reason of the replacement facilities, (5) it was unnecessary for respondent to develop any new source of supply, (6) respondent has the option to maintain the Dunmore No. 7 Reservoir in a future use category for future storage upon the Roaring Brook open channel when the watershed becomes stable.

We shall order the Commonwealth's payment herein to be treated for accounting and ratemaking purposes as a contribution in aid of construction to reflect equitably the interests of the public as well as the interests of respondent.

Based on all of the foregoing, we will disallow from the original cost measure of value $2,558,634 which represents the net of the Commonwealth payment of $2,754,754, less respondent's unrecovered investment in the plant replaced at Dunmore No. 7 Reservoir and Nay Aug Well System of $196,120. In addition, we will give consideration for rate making purposes to the unrecovered investment in our determination of fair value.

• • •

IT IS ORDERED:

1. That the complaints listed in the caption of this Order be and are hereby sustained to the extent indicated by the disallowance of $628,318 of the proposed rate increase.

2. That forthwith respondent file, effective for service rendered on and after the date of this Order or within 30 days thereafter, as respondent may elect, tariffs or tariff supplements containing acceptable rates to provide total annual revenues of $13,491,929 (Spring Brook Division $7,917,989 and Scranton Division $5,573,940, both exclusive of revenues from the State Tax Adjustment Surcharge) as computed herein at the level of operations at September 30, 1972.

3. That detailed calculations be filed with said tariffs or tariff supplements demonstrating that the rates do in fact comply with the requirements set forth in this order.

4. That the new tariffs or tariff supplements give effect to the comments in this order that the Public Authorities and Public Fire Protection customers shall be increased the same percent overall as all other customers. The increase to the Municipal Customers and for Public Fire Protection customers will be effective August 1, 1974. Furthermore, as outlined in this order under contributed property, respondent will correct its accounting entry which credited Other Deferred Credits in the amount of $2,754,754 and will, instead, credit Contributions in Aid of Construction in an amount of $2,558,634 the net proceeds contributed plant in order to properly reflect payment by Pennsylvania Department of Highways (now Pennsylvania Department of Transporation) to Pennsylvania Gas and Water Company for a reservoir and transmission line.

5. That with the filing of said tariffs or tariff supplements respondent may, if it so elects, also file a detailed plan of recoupment of revenues from the application of the allowable rates for water sales rendered on and after March 15, 1974, (as per our temporary rate order) to the date the increased rates approved herein are applied. If respondent elects full or partial recoupment, it may apply the rates filed in compliance with this order to billings rendered after the date of this order or within 30 days thereafter. However, in no case, can these billings be applied to service prior to March 15, 1974.

6. That the surcharge authorized by our State Tax Adjustment Surcharge order of March 10, 1970, be recomputed and revised in accordance with Section B, paragraph 2, of that order.

7. That upon filing the tariffs or tariff supplements, our investigation and inquiry at R. I. D. No. 72 be and is hereby terminated and the record marked closed.

PENNSYLVANIA PUBLIC UTILITY COMMISSION

(signed) George I. Bloom
Chairman

ATTEST:

Secretary

Commissioner Carter reserved decision.

ORDER ADOPTED: JULY 9, 1974.

ORDER ENTERED: JULY 16, 1974

APPENDIX E.

IN THE
COMMONWEALTH COURT OF PENNSYLVANIA

No. 633 C. D. 1974

KEYSTONE WATER COMPANY,
WHITE DEER DISTRICT,
Appellant

v.

PENNSYLVANIA PUBLIC UTILITY
COMMISSION,
Appellee

BEFORE:

HONORABLE JAMES S. BOWMAN, President Judge
HONORABLE JAMES C. CRUMLISH, JR., Judge
HONORABLE HARRY A. KRAMER, Judge
HONORABLE ROY WILKINSON, JR., Judge
HONORABLE GLENN E. MENCER, Judge
HONORABLE THEODORE O. ROGERS, Judge
HONORABLE GENEVIEVE BLATT, Judge

Argued: January 7, 1975

Opinion

OPINION BY JUDGE KRAMER FILED: May 27, 1975

This is an appeal filed by Keystone Water Company—White Deer District (formerly and during the entire record made herein known as White Deer Mountain Water

Company, hereinafter referred to as Keystone) from an order of the Pennsylvania Public Utility Commission (PUC), dated April 17, 1974, setting forth findings of fact and conclusions of law concerning a proposed rate increase by Keystone. The Commission's order contains complicated facts, statistics, and data such as are normally involved in a public utility rate case.

This case had its genesis on April 29, 1969, when Keystone filed an amendment to its tariff providing for increases in all metered water rates, except public fire protection. After hearings the PUC issued its long-form order, dated September 28, 1971, which order was appealed by Keystone to this Court at Nos. 934 and 941 C. D. 1971, apparently because the PUC had excluded from its findings of fair value the cost of a new filtration plant (the same issue which is the subject of the instant appeal). Upon request of the PUC, the case was remanded for the purpose of taking further evidence. At the subsequent hearing it was agreed among all the parties that the record should have incorporated into it the entire record made in the prior proceedings. As a result of these developments, on August 31, 1972, Keystone filed a further supplement to its tariff proposing certain changes under which it proposed to increase its annual operating revenues by $415,477, approximately a 48 percent increase, based upon the level of its operations for the test year ending April 30, 1972. The PUC suspended the effective date of the proposed changes to August 22, 1973, after which time Keystone collected under the proposed rates as temporary rates subject to refund. Because of the very narrow issue presented by this case, we need not go into all the details of the PUC's adjudication except to note that the final order permits a total annual increase in revenues of $365,450 from Keystone's 7,400 customers in Union and Northumberland counties.

To understand the narrow issue involved in this case, it is necessary to describe Keystone's operation. For almost 75 years, one of the three sources of water for Keystone was the White Deer Creek watershed (watershed). The area of the watershed above Keystone's intake point is approximately 37 square miles. The watershed was almost entirely forest land and Keystone owned about 1,300 acres in fee. Approximately 10 percent of the watershed is owned by the Commonwealth and is maintained as state forest land. For the remaining 90 percent, Keystone holds deeds granting water rights dating back to about 1902, wherein it is stated that Keystone has the complete control and use of all the waters and even the right to enter upon the lands at all times for the purpose of maintaining its supply of water. This water was so pure that it required no treatment other than the minimal chlorination required by the Department of Health for all public water companies. In 1959 Keystone became aware that the Commonwealth proposed to construct Interstate Highway I-80 through the valley of the White Deer Creek.[1] Keystone advised the Pennsylvania Department of Transportation (PennDOT) of the danger to its water supply but was unsuccessful in attempting to have I-80 rerouted so as not to touch the watershed. As a result of long, involved negotiations with PennDOT concerning Keystone's condemnation rights, an understanding was reached and reduced to a written agreement dated July 18, 1966. It is well to note at this point that the PUC was not in any way involved in these negotiations.

The July 18, 1966 agreement includes the following provisions:

---

1. We know from prior cases that if a private individual had intended to pollute a watershed such as this, the Commonwealth of Pennsylvania probably would have enjoined him.

"WHEREAS, the construction and improvement of Sections 74, 75 and 76 of said State highway will require the taking by Commonwealth for highway purposes of approximately one hundred thirty (130) acres of the said lands belonging to the Company and *will seriously impair the water rights over the balance of the Company's land in said watershed area required for the protection of the waters of White Deer Creek;* and,

"WHEREAS, it has been agreed between Commonwealth and the Company that the *just compensation,* to which Company is entitled *by reason of said taking of its land, the impairment of its water rights as aforesaid and the cost to insure the continuance of the supply of potable water to the said communities which Company serves, is one million three hundred thousand ($1,300,000.00) dollars,* which is to be made payable in accordance with the terms and conditions hereinafter set forth in this agreement." (Emphasis added.)

The agreement sets forth that the Commonwealth would acquire by deed 130 acres of land owned by Keystone.[2]

Our review of this agreement permits us to conclude that PennDOT was negotiating a settlement under condemnation principles. In the agreement Keystone agreed

2. The record contains a PennDOT memorandum, concerning items to be covered in the agreement, which contains the following paragraph:

"6. The damages are to be $1,300,000, which include, cost to cure on the stream, and the taking of approximately 130 acres of the Water Company land.

Note: The District Office appraisal on the land damages is $3,900."

"at its own cost and expense" to commence the preparation of plans and designs for construction of necessary filtration facilities to insure the continued purity of the water in White Deer Creek. The filtration plant was to be constructed within about 15 months. The Commonwealth of Pennsylvania was to pay Keystone the $1,300,000, immediately upon receipt of the executed deed for the 130 acres of land and notice that Keystone had awarded a contract for the construction of the filtration facilities. PennDOT agreed that it would not commence construction of the highway, so as to affect the watershed, until the filtration plant was in operation. After settlement, which was made March 30, 1967, the company signed a "Receipt and Acquittance" in which it acknowledged receipt of the money "for the taking" of the land, "for the impairment of its water rights within the watershed area", and "for insuring the continuance of the supply of potable water to the communities served by it."

The new filtration plant went into service in the spring of 1968, and its final construction cost was $1,100,000. The record indicates that there were additional costs, but these were not specifically stated. In any event, both the PUC and Keystone agree in their argument that $1,300,000 was utilized by Keystone for this purpose and so we will accept that figure. The record also shows that the annual operating expense of this plant amounts to approximately $50,000 a year. There was no provision in the agreement between Keystone and PennDOT concerning the operating expenses.

This bit of background is necessary for the reason that in the rate case adjudication (both September 28, 1971 and April 17, 1974) the PUC excluded $1,292,347 from the fair original cost and fair value of Keystone's plant which amount represents the $1,300,000 less the PUC's allowance of $2,609 representing its finding of the

value of the 130 acres taken, plus $5,044 of other expenses. In other words, the PUC removed $1,292,347 from the rate base of Keystone for ratemaking purposes. We note that although the PUC, in its adjudication, states that it removed this amount from the fair value, technically that is not correct. They, in effect, removed it from original cost, which is only one of several criteria utilized for determining fair value. As a result of this adjustment, the PUC also disallowed approximately $12,000 a year in annual depreciation based upon the original cost of the filtration plant in question.

The Commission's reasoning was that, based upon equitable principles, it could not "permit . . . [Keystone] to receive all of the salutary effects of the land condemnation and pass them on to the stockholders while passing on all of the deleterious effects of the condemnation to the rate-payers." The PUC garnered from the terms of the agreement of July 18, 1966 an intent on the part of PennDOT to benefit the consumers of Keystone. The PUC stated:

> "Indeed, it is obvious from the terms of the agreement . . . that the major consideration was the need to insure the potability of . . . [Keystone's] White Deer Creek source of supply."

It concluded that with the exception of the minimal amount of dollars represented by the value of the land (which is non-depreciable for accounting or rate-making purposes) and minimal expenses, the balance of the $1,300,000 was for "consequential damages to the rate-payer's service". While counsel for the PUC makes an appealing argument that the rate payers are asked to pay twice for this property, once through the condemnation settlement and once through rates, upon complete analysis,

the argument cannot be supported legally and, therefore, we believe the order of the PUC must be reversed.

We have stated many times that this Court's scope of review is limited both by statute and prior case law. Section 1107 of the Public Utility Law (Act), Act of May 28, 1937, P. L. 1053, *as amended,* 66 P. S. § 1437, provides in pertinent part:

> "The order of the commission shall not be vacated or set aside, either in whole or in part, except for error of law or lack of evidence to support the finding, determination, or order of the commission, or violation of constitutional rights. . . ."

See Lower Paxton Township v. Pennsylvania Public Utility Commission, 13 Pa. Commonwealth Ct. 135, 317 A. 2d 917 (1974); *Pennsylvania Power & Light Co. v. Pennsylvania Public Utility Commission,* 10 Pa. Commonwealth Ct. 328, 311 A. 2d 151 (1973) and *Philadelphia Suburban Transportation Company v. Public Utility Commission,* 3 Pa. Commonwealth Ct. 184, 281 A. 2d 179 (1971).

The basic and narrow issue confronting us is whether the dollars representing the investment in the new infiltration plant should be included in Keystone's rate base for rate-making purposes. We hold that it should be included.

We should immediately emphasize that this is *not* a condemnation case such as was involved in *Pennsylvania Gas & Water Company v. Pennsylvania Turnpike Commission,* 428 Pa. 74, 236 A. 2d 112 (1967). That case, however, is noteworthy and has been cited by both parties, because our Supreme Court held that due to "somewhat unique circumstances" a departure from the traditional test of utilizing fair market value before and after the taking by government would be permitted, in which event the "replacement value or repair test" could be used as a measure of damages. In that case, the government con-

demned a portion of property which had been held for many years in reserve for the use of a water reservoir. The portion which was taken was that portion where the dam had been planned to be built. In effect, the majority of our Supreme Court permitted a recovery of damages based upon construction costs to build the reservoir as it was intended prior to the taking. The instant case is a rate case, and not a condemnation case.

Sections 301-313 of the Act, 66 P. S. §§ 1141-1153, give directions to the PUC to be used in the establishment of just and reasonable rates, but none of these sections specifically states what is to be included within the term "fair value". We are guided, however, by the pronouncements of our Supreme Court in *Scranton v. Scranton Steam Heat Company,* 405 Pa. 397, 176 A. 2d 86 (1961), the facts of which are analogous to this case. There the Scranton Steam Heat Company had purchased the steam heat service facilities of a combination electric and steam utility for $250,000. Although the facilities purchased had an original cost of $2,200.00, they had a much greater reproduction cost. The PUC in that case rejected both the original cost and reproduction cost statistics presented and fixed its fair value on the acquisition cost alone. Our Supreme Court, in sustaining the Superior Court's reversal of the PUC, stated:

> "Acquisition cost is not and never has been in Pennsylvania the criterion of 'fair value' or a substitute for either or both the factors of original cost of construction or reproduction cost . . ." (Citations omitted.) 405 Pa. At 402-403, 176 A. 2d at 89.

The *Scranton* Court also stated:

> "More than half a century ago it was held that 'the basis of all calculations as to the reasonableness of rates to be charged . . . must be the the fair value of

> the property being used by it for the convenience of the public. . . . What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience'. . . ." (Citations omitted.) 405 Pa. at 401, 176 A. 2d at 88.

The Court then went on and noted that fair value for rate-making purposes has a connotation peculiar to rate proceedings, and that there is no precise formula by which the Commission is bound in fixing the rate base. The question before us in this case, however, is not whether the value allowed for rate-making purposes by the PUC was one of several possible valuations, but rather, whether the PUC's action in entirely eliminating this piece of property from the rate base was proper.

At the very root of this issue there are certain fundamental constitutional rights involved. Both the Fifth and Fourteenth Amendments to the United States Constitution and Article I, sections 9 and 10 of the Pennsylvania Constitution of 1968 provide that no person may be deprived of his property without due process of law and that private property may not be taken or applied to the public use without just compensation. These principles are as old as the Magna Charta. Our Pennsylvania Supreme Court has affirmed these principles at every opportunity. *Andress v. Zoning Board of Adjustment,* 410 Pa. 77, 188 A. 2d 709 (1963); *Lord Appeal,* 368 Pa. 121, 81 A. 2d 533 (1951); and *White's Appeal,* 287 Pa. 259, 134 A. 409 (1926). In applying these constitutional principles to public utility regulation, the appellate courts of this Commonwealth have stated over and over again that the rates set by the Commission must not be confiscatory. It has been held that confiscation results when the order of the Commission refuses the utility company an opportunity to earn a fair return upon the fair value of its property devoted to the

public service. *See Ben Avon Borough v. Ohio Valley Water Co.*, 271 Pa. 346, 114 A. 369 (1921); *Pittsburgh v. Pennsylvania Public Utility Commission*, 182 Pa. Superior Ct. 551, 128 A. 2d 372 (1956); *Solar Electric Co. v. Pennsylvania Public Utility Commission*, 137 Pa. Superior Ct. 325, 9 A. 2d 447 (1939); and *Beaver Valley Water Co. v. The Public Service Commission*, 76 Pa. Superior Ct. 255 (1921), aff'd. 271 Pa. 358, 114 A. 373 (1921). In this case Keystone is a public utility and is required by law to provide adequate and continuous water service to its customers. To explain our conclusion that the Commission violated these basic principles and thereby committed an error of law, we turn now to a discussion of what the Commission did in this case.

The PUC stated in its adjudication that the result of its elimination of any value for the filtration plant from the rate base equitably establishes "the pre-condemnation status quo, [that is that] both the utility and its customers must be made whole insofar as reasonably possible." But the facts of the case do not support that conclusion. Prior to the taking by PennDOT, Keystone had acquired deeded rights to the pure water in almost all of this 37-square-mile watershed. Those rights had value. True enough, those rights were carried on the books of Keystone at what appears to be nominal evaluation because the value was set in 1902 when a dollar purchased much more than it does today. Under accounting principles, the value of these rights was required to be carried on the books at original cost. That does not say that whatever property rights Keystone had actually had a fair value for condemnation purposes of only the nominal amounts carried on books. On March 30, 1967, when PennDOT and Keystone made settlement under their agreement, property which had value was taken from Keystone and its stockholders, so that what remained had less value to the stockholders than

what had existed prior thereto. No matter what reasons PennDOT may have had in reaching the dollar settlement, it is apparent that under the reasoning of *Pennsylvania Gas & Water Company, supra,* Keystone was entitled to the "repair or replacement value" of that which was taken from it. In this case, what was taken from it were its water rights and some of its property rights in the watershed which would be polluted by the construction of I-80. In its brief the PUC argued that the purpose of the payment of $1,300,000 was to protect the rights of Keystone's customers to a continuing supply of potable water, but the record just does not support that contention. First of all, we can find nothing in the law which would authorize PennDOT to contribute or donate money to anyone, and the PUC cites no such authority. We do find specifically that PennDOT may pay "damages". For example, section 8 of the Pennsylvania Limited Access Highways Act, Act of May 29, 1945, P. L. 1108, *as amended,* 36 P. S. § 2391.8, reads in pertinent part as follows:

> "For the purpose of constructing limited access highways . . . the Secretary of Highways is hereby empowered to take property and pay damages therefor as herein provided."

Secondly, the record proves beyond cavil that in addition to the cost of constructing the filtration plant, therewill be a continuing annual expense of at least $50,000 per year to operate that plant. If the government's intention was to continue a supply of potable water, then why also did it not include payment of $50,000 a year to run the plant. If it had included such payment, then some credence could be given to the PUC's argument.

Throughout its argument, the PUC says that the money PennDOT paid was based upon a "cost to cure" measure of damages, and that somehow this theory of

condemnation can be transformed into a principle of rate making. We can find no support for this contention in the law applicable to rate cases.

Another contention of the PUC is that its adjudication in no way affects Keystone's ownership of the filtration plant or the interest of its stockholders therein. Once again, the record does not support such a contention. Two sentences found in the PUC's brief prove our point:

> "In such a transaction such stockholders would, indisputably, be free to ask whatever price they should choose for the property of respondent, including the filter plant. In determining such price they would be equally free to set the value of the filter plant at whatever they may wish and should a purchaser subsequently be willing to pay such asking price the stockholders and *not the rate paying customers would be entitled to receive it.*" (Emphasis in original.)

We agree with these statements, and they support the proposition that the stockholders own the filtration plant. Keystone's ratepayers do not own it in any fashion. Counsel for the PUC quite frankly admitted that if Keystone had dissolved its corporate existence on the day after it received the $1,300,000 that money would have gone to its creditors and any balance to its stockholders. The ratepayers would not have received one dollar of that amount. One of the leading constitutional cases in this field is the decision of the United States Supreme Court in *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U. S. 23 (1926) where the Court enunciated the principle that the utility plant of a privately-owned utility belongs to its stockholders not to its ratepayers. The Court stated:

> "Customers pay for service, not for the property used to render it. . . . By paying bills for service they

> do not acquire any interest, legal or equitable, in the property user for their convenience or in the funds of the company." 271 U. S. at 32.

The Court further noted that a utility is entitled to a reasonable return on the value of the property used for public service regardless of the source of the money used to construct the property. In this connection it stated:

> "The just compensation safeguarded to the utility by the Fourteenth Amendment is a reasonable return on the value of the property used at the time that it is being used for the public service, and rates not sufficient to yield that return are confiscatory . . . Constitutional protection against confiscation does not depend on the source of the money used to purchase the property. It is enough that it is used to render the service." (Citations omitted) 271 U. S. at 31.

These same principles must apply to the PUC's elimination of the annual depreciation applicable to the filtration plant. The company claimed $62,743 for annual depreciation on the original cost of its plant in service on April 30, 1972. Because of the disallowance of the filtration plant, the Commission allowed only $50,669 for total annual depreciation. The difference then is $12,074, which would appear to be the annual depreciation charge attributable to the filtration plant. In this connection our Superior Court in *Penn Sheraton Hotel v. Pennsylvania Public Utility Commission*, 198 Pa. Superior Ct. 618, 627, 134 A. 2d 324, 328-329 (1962), stated:

> "Annual depreciation is an operating expense representing the consumption of assets in rendering service. A utility is entitled under the law to recover from the rate payers the original cost of construction of its depreciable plant."

This principle was restated by our Court in *Pennsylvania Power & Light Company v. Pennsylvania Public Utility Commission,* 10 Pa. Commonwealth Ct. 328, 311 A. 2d 151 (1973). The PUC takes the attitude that somehow the rights of Keystone and its stockholders are protected by its adjudication despite the elimination of the depreciation applicable to the filtration plant. Nothing could be further from the truth. If we assume this filtration plant had, for instance, a ten-year life, then five years from the day it went into operation, if the company was sold or dissolved, it can be assumed that the selling price would be something substantially less than 100 percent of the value determined on the day it went into service. Under these facts, how could the stockholders of Keystone possibly be protected? They have lost whatever value their company had in that portion of the 37 square mile watershed area which was polluted or taken by virtue of I-80, and they are left with a plant worth less than the amount which had been determined to be the appropriate damages under the condemnation agreement. A failure to recognize this is clearly an error of law because the PUC's adjudication results in a taking of Keystone's property. There is no way that the PUC can support its conclusion that the $1,300,000 payment by PennDOT became the property of the rate payers. If further proof were needed, we point out the fact that if this filtration plant had cost $2,000,000 rather than $1,300,000, can there be any question even under the PUC's reasoning that $700,000 would have to be placed in the rate base in this case. That being so, does that mean that the rate payer would have some right against PennDOT or against Keystone for not computing sufficient damages? We know of no such right.

The PUC's bases its approach to this case on the alleged inequity of taxpayers paying money damages to

Keystone which are utilized in the construction of a filtration plant and thereafter the rate payers paying a second time through depreciation and earnings on the value of that plant. Although it does not negate the PUC equity argument, we should not lose sight of the fact that apparently 90 percent of the state's payment of these damages was paid by the federal government. We also should not lose sight of the fact that it was for the benefit of the public I-80 was constructed. So all of the people in the area, including the consumers of Keystone, obtain the benefit of the use of the new public super highway. Be that as it may, the PUC has advanced the novel theory that a privately-owned public utility may be forced to operate a plant representing 20 percent of its net investments in total plant without any earnings whatsoever. The PUC, under its adjudication, of course, permits Keystone to recover the expenses involved in operating this filtration plant, but under the cost of service rate-making process a utility *earns* nothing on expenses. A utility earns only on the net fair value of its plant. In other words, if a person would receive as a gift or through inheritance a public utility, according to the PUC adjudication that person would be under a duty to operate the plant for the benefit of the consumers without the possibility of earning any profit. That kind of reasoning flies in the face of our Supreme Court's holding in *Scranton, supra.* In *Peoples Natural Gas Company v. Pennsylvania Public Utility Commission,* 153 Pa. Superior Ct. 475, 34 A. 2d 375 (1943), it was argued that if a utility had accumulated a depreciation reserve while consistently earning and paying liberal dividends, that the consumers or rate payers should become the real owners of the property bought with the depreciation funds and ought not to pay a return on it. The Superior Court answered that argument as follows:

> "But this ought-not argument can be disposed of by pointing out that, under the existing law, the only test is present fair value of the property used and useful in rendering the service. That appellant [the utility] owns the property and is using it in the service is unquestioned. And, so long as present fair value is the test, it makes no difference whether appellant bought it, received it as a gift, or won it in a lottery." 153 Pa. Superior Ct. 486, 34 A. 2d at 381.

Our appellate courts have consistently held that the source of the funds used to finance the construction of the property used in the public service by a public utility must be included in the rate base. In *Beaver Valley Water Company, supra,* the Commission had excluded from the rate base the cost of construction of a dam by a water public utility, the money for which came from a railroad pursuant to an agreement for the taking of the utility's property. In overruling the Commission the Court held:

> "It matters not who paid for it if it forms part of the appellant's [utility's] plant and is used in connection with the public service. It is no part of our duty to measure the value of the consideration given by appellant under said agreement. If the railroad company had built the entire dam in return for such consideration, the appellant would have been entitled to have had its value included in the valuation of its property for rate-making purposes." 76 Pa. Superior Ct. at 263-264.

> "It follows that as the order of the Commission would require the appellant to render its service to the public at rates based upon the value of only $985,000, when for rate-making purposes its property

> devoted to the public use is valued at over $1,475,000, it is confiscatory and in violation of the due process clause of the federal Constitution." 76 Pa. Superior Ct. at 272.

In *Borough of Lewistown v. Public Service Commission*, 80 Pa. Superior Ct. 528, 531-532 (1923), the Court stated:

> "[T]he commission is not restricted to allowance of a fair return upon the amount of capital actually invested by the owners. . . . The true role is that the company is entitled to a rate which will allow a just and reasonable return on the present fair value of its property used and useful in the public service. . . ." (Citations omitted.)

The only exception which we have been able to discover to this general constitutional principle is for true donations or contributions made by customers toward the cost of facilities necessary to obtain service by those customers. For example, if a customer is beyond the permitted extension distance of a utility service necessitating construction of facilities which all of the customers of the company should not be made to bear, then the customer contributes or donates that portion of the service facility beyond the permitted distance and for obvious reasons, the utility should not be permitted to earn upon such an investment by the customer. In such cases the cost of such an investment in facilities by the customer properly should be carried on the books of the utility as a donation or contribution and not as part of its plant. The case before us is not such a situation.

As part of its adjudication, the PUC found fault with the manner in which Keystone accounted for the payment of the $1,300,000 from PennDOT. Keystone placed this money, for accounting purposes, in account

No. 401 entitled "Miscellaneous Credits to Surplus". Regarding account No. 401, the Pennsylvania Uniform System of Accounts provides that:

> "Any difference between the amount received from the sale of land or land rights, less agents' commissions and other costs incident to the sale and the book cost of such land or rights, shall be charged to account 414, Miscellaneous Debits to Surplus, or credited to account 401, Miscellaneous Credits to Surplus, as appropriate."

Because the PUC deemed the $1,300,000 payment to be more a contribution or donation to the consumers (although the consumers were not mentioned anywhere in the agreement), the PUC ordered Keystone to transfer the funds to another account, No. 265, entitled "Contributions in Aid of Construction." Concerning account No. 265, the Pennsylvania Uniform System of Accounts provides:

> "This account shall include donations or contributions in cash, services or property from states, municipalities or other governmental agencies, individuals and others for construction purposes."

While the niceties of this accounting issue are not dispositive of this case, we direct the PUC to the holdings mentioned in this opinion, which we believe support the accounting procedure used by Keystone.

In summary then, we hold that the payment of $1,300,000 to Keystone by PennDOT was a payment in money damages or just compensation for the taking of Keystone's property as measured by the value of the land taken, the value of the deeded water rights taken, and also for the replacement costs involved in insuring

the continuance of supply of potable water to Keystone's customers, the latter damages of which were measured by the "cost to cure" method. Upon payment of those damages, the money was properly accounted for in the surplus account because that money belonged to the stockholders of Keystone.[3] We hold that the money or property of the stockholders of Keystone having been invested in a filtration plant used and useful in the public service of Keystone's customers, the value of that plant should have been included in the various original costs, reproduction costs (or trended original costs) and fair value evaluations as part of the total rate base of Keystone for rate-making purposes. We hold that since the filtration plant should be made a part of the rate base for rate-making purposes that annual depreciation should be allowed so that Keystone may recoup this investment over the life of the plant. In view of these holdings, we must reverse the PUC and remand this matter to it for the purpose of amending the cost of service in a manner not inconsistent with this opinion. We therefore

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3. The record indicates that Keystone did not directly pay for the construction of the filtration plant with the monies it received from PennDOT. The monies were placed into its general funds. At the time of the building of the filtration plant on White Deer Creek, Keystone was also building another plant on the Susquehanna River at a comparable cost. During the period of time when the money ($1,300,000) was being paid and the White Deer Creek filtration plant was being constructed, Keystone also financed the construction of the other filtration plant, and the record indicates that Keystone used both the monies raised by the bond issue and the PennDOT damage settlement payment as general funds for both constructions. In other words, it was not possible to trace the PennDOT payment directly to the White Deer Creek filtration plant. But there is no question that the PennDOT payment was not paid out as extraordinary dividends, but rather was utilized in the construction of the plants for service to Keystone's customers.

Order

AND Now, this 27th day of May , 1975, based upon the above discussion, the order of the Pennsylvania Public Utility Commission dated April 17, 1974 in the above-captioned matter is hereby reversed and this matter is remanded back to the Commission for the purpose of amending its rate base statistics so as to include the fair value of the filtration plant constructed on the White Deer Creek, to amend its allowance for annual depreciation so as to include annual depreciation in an amount sufficient to permit the recovery of the investment in the filtration plant located on White Deer Creek for the life of that plant, and to amend its cost of service statistics so as to show these two amendments with the resultant increased return and total allowable operating revenues, and it is further ordered that after the recalculation and amendments are completed, the Commission shall issue a new order providing for the collection of the total revenues allowable through the filing of a new supplement to the tariff effective and collectible under the provisions of the law.

/s/ HARRY A. KRAMER
Harry A. Kramer, *Judge*

Judge Wilkinson concurs in the result only.

IN THE
COMMONWEALTH COURT OF PENNSYLVANIA

No. 633 C. D. 1974

KEYSTONE WATER COMPANY,
WHITE DEER DISTRICT,
Appellant

v.

PENNSYLVANIA PUBLIC UTILITY
COMMISSION,
Appellee

BEFORE:

HONORABLE JAMES S. BOWMAN, President Judge
HONORABLE JAMES C. CRUMLISH, JR., Judge
HONORABLE HARRY A. KRAMER, Judge
HONORABLE ROY WILKINSON, JR., Judge
HONORABLE GLENN E. MENCER, Judge
HONORABLE THEODORE O. ROGERS, Judge
HONORABLE GENEVIEVE BLATT, Judge

ARGUED: January 7, 1975

Dissenting Opinion

FILED:

DISSENTING OPINION BY JUDGE BLATT MAY 27, 1975

In reviewing the proposed tariff by the Keystone Water Company—White Deer District (Keystone), the Public Utility Commission (PUC) excluded from the rate base $1,292,000 representing the amount contributed by

the Commonwealth, Department of Transportation (PennDOT) as that part of the condemnation award allocable to the construction of a water filtration plant, a necessary functional substitute for the land taken by PennDOT when it constructed Interstate Route 80 across the watershed utilized by Keystone as its water source. Without the filtration plant clean potable water could no longer be supplied to Keystone customers.

The PUC apparently concluded that because Keystone had no investment in the plant the customers should not be subject to a rate increase which would result in their having to pay for the plant twice—once through tax dollars and a second time through rates charged by the utility company. Perhaps more important is the fact that the PUC has refused to subject the paying customers to rate increases where they will not receive improvements in services, and where the company made no business investment upon which it can equitably claim a right to earnings.

The majority holds that to exclude from the rate base the dollar amount consumed in construction of the new filtration plant would amount to a confiscation of Keystone's property in violation of the Fifth and Fourteenth Amendments to the United States Constitution and Article I, Sections 9 and 10 of the Pennsylvania Constitution of 1968. I disagree and must, therefore, respectfully dissent.

The majority relies upon the basic proposition that a utility is entitled to receive a fair return on the fair value of its property used and useful in the public service without regard to the source of the money used to purchase the property, citing *Board of Public Utility Commissioners v. New York Telephone Company*, 271 U.S. 23 (1926) and *Peoples Natural Gas Company v. Pennsylvania Utility Commission*, 153 Pa. Superior Ct. 475, 34 A. 2d 375 (1943). However appropriate this proposition may be in the nor-

mal case, this is not such a case. And, as I view the PUC's departure from the rule, it is both constitutional and just under the laws of Pennsylvania.

Initially I do not believe that the action of the PUC raises issues of constitutional dimension. It is no longer a constitutional requirement that utilities earn a "fair return" on the "fair value" of the property devoted to the public use. What the Constitution requires is that rates be "just and reasonable" so as to provide the equity owners a return commensurate with other enterprises having corresponding risks. *Federal Power Commission v. Hope Natural Gas Company,* 320 U. S. 591 (1944); *Cities Service Gas Co. v. Federal Power Commission,* 155 F. 2d 694 (10th Cir. 1946). These requirements are distinguished in that the return upon the individual or collective values of property no longer determines the constitutionality of a rate schedule; it is determined instead by the justness and reasonableness of the impact of the final rate upon the utility. The return, therefore, should be sufficient so as to allow the regulated company to operate successfully, maintain its financial integrity, attract capital, and compensate its investors for the risks assumed. *See Federal Power Commission* and *Cities Service Gas Co., supra.* There is not even a suggestion that under this constitutional standard the return allowed by the PUC in this case was not sufficiently met. It seems to me, therefore, that what this Court should have determined is whether or not the PUC ruling fell within the Commission's statutory authority.

Under the Public Utility Law[1] (Act) "[e]very rate made, demanded, or received by any public utility . . . shall be just and reasonable." Section 301 of the Act, 66 P. S. § 1141. Under judicial interpretation "just and reason-

1. Act of May 28, 1937, P. L. 1053, *as amended,* 66 P. S. § 1101 et seq.

able" have been construed so that a utility might receive a fair return upon the fair value of that which it employs for the public convenience. *Scranton v. Scranton Steam Heat Company,* 405 Pa. 397, 176 A. 2d 86 (1961). On the other hand it cannot be disputed that the words "just and reasonable" indicate that the public is entitled to demand that no more be exacted from it for the use of services rendered by a utility than those services are reasonably worth. *Smyth v. Ames,* 169 U. S. 466 (1898). Are the services of the Keystone here worth any more because they are provided through a new filtration plant constructed out of public moneys? Are the equity investors entitled to any greater return or greater profits as a just and reasonable consequence of the fortuitous condemnation of their watershed where its functional substitute has been provided through public moneys? Surely the answer to both must be in the negative.

The heart and substance of the PUC's determination, and the factor which distinguishes this case from those cited by the majority is the fact that the filtration plant here was constructed with public money designated for that purpose. In those cases cited by the majority the properties included in the rate base were acquired as a result of normal business judgments and investment concepts even though the money used in the acquisitions was not derived from the capital contribution of the equity holders. And, of course, the company should be entitled to reap the benefits of *its* prudent financial decision making. This case lacks similarity for when the condemnation taking occurred Keystone was obligated absolutely to allocate the money received by the condemnation award to the construction of the new filtration plant. The majority departs from this interpretation stating that the condemnation award merely compensates the utility for the taking of the land as in any condemnation case, and thus

the majority suggests that the plant was constructed through company investments from a general company fund. Such an interpretation, however, is belied by the express terms of the condemnation agreement and ignores the true character of this unusual situation. As I view the PUC decision, Keystone would not be forced to operate a plant representing 20 percent of its net investments without any earning whatsoever as the majority postulates.

It might be added, as the majority observes, that the PUC did permit Keystone to recover the expenses involved in operating this filtration plant. This was proper, of course, as the company must be permitted to recover its expenses. The majority also observes that the PUC failed to allow Keystone to recover annual depreciation of the plant as an operating expense. Inasmuch as depreciation *is* an operating expense, *Penn Sheraton Hotel v. Pennsylvania Public Utility Commission*, 198 Pa. Superior Ct. 618, 184 A. 2d 324 (1962), the PUC should have provided some means by which Keystone could have recovered this expense through the rate paying customers even though the plant itself was excluded from the rate base.

Because of the need, however, to balance the interests of the equity holders in Keystone against the interests of the rate paying public, I believe that it was just and reasonable for the PUC to exclude the $1,292,000 allocated to the filtration plant from the rate base in this case. I, therefore, dissent.

/s/ GENEVIEVE BLATT
Genevieve Blatt, *Judge*

APPENDIX F.

SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

No. 46 MAY TERM, 1976

KEYSTONE WATER CO.,
WHITE DEER DISTRICT

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

Judgment

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the judgment of the Commonwealth Court of Pennsylvania be, and the same is hereby affirmed.

/s/ MILDRED E. WILLIAMSON
Deputy Prothonotary

Dated: April 7, 1978

IN THE
THE SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

No. 46 MAY TERM, 1976

KEYSTONE WATER COMPANY,
WHITE DEER DISTRICT

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant.

Appeal from Order of the Commonwealth Court of Pennsylvania dated May 27, 1975, at No. 633 C. D. of 1974.

Opinion

PER CURIAM FILED: April 7, 1978

The Court being equally divided, the order of the Commonwealth Court is affirmed.

Mr. Justice POMEROY filed an opinion in support of affirmance joined by Mr. Justice O'BRIEN and Mr. Justice MANDERINO.

Mr. Justice ROBERTS filed an opinion in support of reversal joined by Mr. Chief Justice EAGEN and Mr. Justice NIX.

Former Chief Justice JONES did not participate in the decision of this case.

IN THE
THE SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

No. 46 MAY TERM, 1976

KEYSTONE WATER COMPANY,
WHITE DEER DISTRICT

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant.

Appeal from Order of the Commonwealth Court of Pennsylvania dated May 27, 1975, at No. 633 C. D. of 1974.

Opinion in Support of Affirmance

POMEROY, *J.*, FILED: April 7, 1978

In this public utility rate case, the Pennsylvania Public Utility Commission (PUC) appeals from a decision of the Commonwealth Court to reverse an order of the PUC which had disallowed $57,906 from a general rate increase proposed by the appellee water utility, Keystone Water Company—White Deer District (Keystone). *See* 19 Pa. Cmwlth. 292, 339 A. 2d 873 (1975).* The subscribers to this opinion would affirm the order of the Commonwealth Court.

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* The Public Utility Commission petitioned this Court for leave to appeal under Sec. 204 of the Appellate Court Jurisdiction Act, Act of July 31, P. L. 673, No. 223, art. II, 17 P. S. § 211.204(a), and we granted the petition.

This case arises from Keystone's filing on August 31, 1972, of a supplement to its existing water tariff. The supplement proposed changes in all metered rates sufficient to produce an increase in annual revenues of $415,477.[1] Pursuant to an investigation of the reasonableness of these rates, the PUC issued an order postponing the effective date of the increase until August 22, 1973; thereafter the new rates were deemed temporary pending a final PUC adjudication. Based upon hearings and the submission of appropriate data, the Commission entered a detailed final order on April 17, 1974. Of Keystone's $423,356 requested increase in revenues (as revised), $365,450 or 86 per cent was permitted. This decrease of $57,906 is principally explained by the fact that the PUC excluded from the computation of the rate base the value of Keystone's White Deer Creek filtration plant; the Commission also eliminated from allowable operating expenses the annual depreciation chargeable to the plant. This determination by the PUC to ignore Keystone's filtration plant for rate-setting purposes is the single issue in this appeal.

To appreciate the basis for the Commission's action, some background is necessary. We quote from the summarized facts as set forth in the opinion of the late Judge Kramer, writing for the Commonwealth Court majority: [2]

> "For almost 75 years, one of the three sources of water for Keystone was the White Deer Creek watershed (watershed). The area of the watershed above Keystone's intake point is approximately 37 square miles. The watershed was almost entirely

1. This sum constituted a 48 per cent increase over the level of operations for the test year ending April 30, 1972. Since 1927, Keystone has had one general rate increase, that one becoming effective on November 13, 1958.

2. A dissenting opinion was filed by Judge Blatt.

forest land and Keystone owned about 1,300 acres in fee. Approximately 10 per cent of the watershed is owned by the Commonwealth and is maintained as state forest land. For the remaining 90 per cent, Keystone holds deeds granting water rights dating back to about 1902, wherein it is stated that Keystone has the complete control and use of all the waters and the right to enter upon the land at all times for the purpose of maintaining its supply of water. This water was so pure that it required no treatment other than the minimal chlorination required by the Department of Health for all water companies. In 1959 Keystone became aware that the Commonwealth proposed to construct Interstate Highway I-80 through the valley of the White Deer Creek. Keystone advised the Pennsylvania Department of Transportation (PennDOT) of the danger to its water supply but was unsuccessful in attempting to have I-80 rerouted so as not to touch the watershed. As a result of long, involved negotiations with PennDOT concerning Keystone's condemnation rights, an understanding was reached and reduced to a written agreement dated July 18, 1966." 19 Pa. Cmwlth. 292, 295-96, 339 A. 2d 873, 874 (1975) (footnote omitted.)

Settlement under the July 18, 1966 condemnation agreement between the Pennsylvania Department of Transportation and Keystone Water Company, the pertinent portions of which are quoted in the margin,[3]

3. The July 18, 1966 agreement between Keystone and the Department of Transportation states in relevant part:

"WHEREAS, the construction and improvement of Sections 74, 75 and 76 of said State highway will require the *taking by Commonwealth* for highway purposes of approximately one hundred thirty (130) acres of the said lands belonging to the

was made on March 30, 1967. In the spring of 1968, construction of a new filter plant built at Keystone's expense, as provided by the agreement, was completed. The cost of construction of the plant was $1,100,000. Additional expenses related to the condemnation and the building of the new plant brought Keystone's total investment in the project to approximately $1,300,000, a sum

3. (Cont'd.)

Company and *will seriously impair the water rights over the balance of the Compnay's land in said watershed area required for the protection of the waters of White Deer Creek*: and

"WHEREAS, it has been agreed between Commonwealth and the Company that the *just compensation, to which Company is entitled by reason of said taking of its land, the impairment of its water rights as aforesaid and the cost to insure the continuance of the supply of potable water to the said communities which Company serves,* is one million three hundred thousand ($1,300,000.00) dollars, which is to be made payable in accordance with the terms and conditions hereinafter set forth in this agreement.

• • •

"1. Company, upon execution of this agreement, *will at its own cost and expense* commence the preparation of plans and designs for the construction of such facilities as may be necessary to insure the continued purity, as required for public consumption of the waters of White Deer Creek in Union County, Pennsylvania, and shall submit such completed plans and designs to the appropriate regulatory agencies of the Commonwealth within a period of six (6) months from the date of the execution of this agreement.

• • •

"4. Commonwealth will pay to the Company the sum of one million three hundred thousand ($1,300,000.00) dollars immediately upon receipt of the executed deed [for 130 acres of Keystone's land] required in paragraph numbered 3 hereof and notice of the award by Company of the contract or contracts for the construction of the facilities as provided for in paragraph numbered 2 hereof." (Emphasis added).

equivalent to that paid by PennDOT to Keystone pursuant to the terms of the agreement. *See* n. 3, *supra.*

In its 1974 rate adjudication, the PUC undertook a review of the 1967 PennDOT condemnation settlement. It construed the terms of the parties' written agreement as compensating Keystone only for the value of 130 acres of land to which PennDOT took title.[4] The remainder of the amount paid in settlement ($1,292,347), according to the PUC, was intended to remedy "consequential damages" suffered not by the utility, but by its ratepaying customers. As support for this theory, the PUC in its memorandum order pointed to the agreement provision requiring the utility company to construct a filter plant which would restore the potability of the White Deer Creek water supply. The Commission thus ordered that $1,292,347 be excluded from the calculation of rate base.

On appeal, the Commonwealth Court rejected the PUC theory and held as follows:

> "[T]he payment of $1,300,000 to Keystone by PennDOT was a payment in money damages or just compensation for the taking of Keystone's property as measured by the value of the land taken, the value of the deeded water rights taken, and also for the replacement costs involved in insuring the continuance of supply of potable water to Keystone's customers, the latter damages of which were measured by the 'cost to cure' method. Upon payment of those damages, the money was properly accounted for in the surplus account because that money belonged to the stockholders of Keystone. We hold

4. The original cost of this acreage was $2,609, to which was added $5,044 representing other unidentified expenses attributable to that property.

that the money or property of the stockholders of Keystone having been invested in a filtration plant used and useful in the public service of Keystone's customers, the value of that plant should have been included in the various original costs, reproduction costs (or trended original costs) and fair value evaluations as part of the total rate base of Keystone for rate-making purposes. We hold that since the filtration plant should be made a part of the rate base for rate-making purposes that annual depreciation should be allowed so that Keystone may recoup this investment over the life of the plant. In view of these holdings, we must reverse the PUC and remand this matter to it for the purpose of amending the cost of service . . . ." 19 Pa. Cmwlth. at 310-11 (footnote omitted).

For reasons stated in Part I of this opinion, we concur in the holding of the Commonwealth Court that Keystone's filtration plant must be included in rate base for purposes of calculating allowable return on investment, as well as allowable depreciation expense. In Part II, we address the principal argument put to us by the PUC in the instant appeal, *viz.*, that the Commission is free to depart from adherence to the rate base method of utility rate adjudication wherever the end result (i.e., the revenue which the utility is permitted to earn) is deemed to be "just and reasonable."

I.

We find no legal or factual support [5] for the conclusion of the PUC that most of the dollars representing Key-

5. The scope of appellate review of a PUC order is limited by § 1107 of the Public Utility Law, Act of May 28, 1937, P. L. 1053, *as amended*, 66 P. S. § 1437:

stone's filtration plant were not damages properly belonging to Keystone as compensation for the 1966 taking of its watershed land and valuable easement rights,[6] but were "consequential damages" owing to utility consumers and thus excludable from Keystone's rate base. It is our view that the proper interpretation of the PennDOT-Keystone agreement of July 18, 1966 is that it represents a settlement negotiated by the parties thereto pursuant to established condemnation principles, and that the proceeds therefrom were thus the property of Keystone and its shareholders.

It is true, as is emphasized in the Commission's order, that the agreement was intended to insure the "continuance of a supply of potable water to the communities which [the] Company serves." That feature of the settlement, however, was simply reflective of applicable condemnation law, which envisions that the injured utility will remedy the damage done to its service capacity. In *Pa. Gas & Water Co. v. Pa. Turnpike Commission*, 428 Pa. 74, 236 A. 2d 112 (1967), this Court ruled that land held for reservoir purposes by a water utility was to be compensated for, when condemned by the Turnpike Commission, on a basis of cost to "replace or repair", rather than

5. (Cont'd.)

"The order of the commission shall not be vacated or set aside, either in whole or in part, except for error of law or lack of evidence to support the finding, determination, or order of the commission, or violation of constitutional rights."

See *Philadelphia Suburban Water Co. v. Pa. P. U. C.*, 425 Pa. 501, 508, 229 A. 2d 748, 752 (1967).

6. For a discussion of the value of these rights, see the opinion of the Commonwealth Court herein, 19 Pa. Cmwlth. at 303. We note that such rights have been held to be properly includable in rate base. See *Beaver Valley Water Co. v. Public Service Commission*, 76 Pa. Super. 255 (1921); *P. U. C. v. York Water Co.*, 44 P. U. C. 1, 77 P. U. R. 3d 113 (1968).

the more typical "fair market value" calculation of damages. See also *McSorley v. Avalon Borough School District*, 271 Pa. 252, 137 A. 848 (1927). This was principally because there existed no market for such utility property. 428 Pa. at 83. In the present case, it was certainly no less difficult to arrive at a market value for Keystone's watershed property. The parties accordingly chose to settle on this "cost to cure" basis.[7] That the parties went a step further and agreed that the condemnee would in fact repair the damage done to its watershed by constructing facilities to insure continued purity of the water supply does not alter the fact that the settlement figure represented compensation for Keystone's loss, not a gift or donation by PennDOT to either Keystone or its customers.[8] The Public Utility Commission in its rate adjudication effectively rewrote the Keystone-PennDOT agreement so as to delete the provision granting com-

7. One of the references in the record to this mode of expressing the measure of damages in cases of this sort is contained in a letter from the Chief Counsel of PennDOT to the United States Department of Transportation. The letter states in part:

> "A review of the laws pertaining to Eminent Domain in Pennsylvania convinces me that if this can be done on a cost to cure basis, there is nothing legally incorrect with this approach, particularly when, as in this matter, other methods of compensation would result in prohibitively high payment." (Record at 280.)

See also the opinion below, 19 Pa. Cmwlth. at 297 n. 2.

No estimate of the cost of purification facilities is in the record or referred to in the agreement. Thus Keystone's obligation to construct a treatment plant was not conditioned on the cost thereof, which might have been either greater or less than $1,300,000.

8. As the Commonwealth Court noted, 19 Pa. Cmwlth. at 303-04, there is no authority for any such donation by PennDOT; rather it is empowered, for example, "to take property and pay damages." Limited Access Highways Act, Act of May 29, 1945, P. L. 1108, § 8, *as amended*, 36 P. S. 2391.8.

pensation in the sum of $1.3 million, representing the watershed value of the condemned acreage (including value derived from deeded easements) and inserted in its place a provision bestowing a gratuity in like amount on Keystone customers. We believe that in so doing it committed error.

The PUC argues, however, that its order was compelled by equitable considerations which also dictate the affirmance of that order. It is argued that to permit Keystone to obtain a return on the filter plant is to confer a windfall on the utility to the detriment of the rate paying public. We cannot agree with this assertion. The PUC's equity argument seems to reflect concern with the disparity between the carrying value of the land and water rights taken or destroyed by the condemnation, and the amount agreed upon in settlement, coupled with the fact that this amount bears a close correlation to the cost of the new plant. But the matter must be seen in context. The fact is that the water rights taken, whatever their cost of acquisition many years ago, were of unique value to Keystone, and only to Keystone. The current value of these property rights was not ascertainable by conventional methods because there was obviously no market for them at the time of condemnation. Keystone was sufficiently farsighted at the turn of the century to procure easements which were extensive enough to assure a plentiful source of pure water, a supply kept untouched by polluting influences with which our land and streams are today afflicted. It should not be penalized because of the fact that the only standard of compensation for the loss of such an asset is the amount necessary to be spent in order to accomplish by artificial means what formerly was accomplished by natural means. That this amount is substantially greater than the original investment of Keystone in its property rights is an irrelevancy, and in no wise con-

verts the settlement with PennDOT from damages for a taking into a voluntary contribution. Without the construction of the new plant the customers of Keystone would have been without drinking water (a circumstance caused by PennDOT, not Keystone); thus they have been benefited by that construction. It does not seem unjust that the rates charged to consumers should be increased to reflect the costs of obtaining purity by artificial rather than natural means. Conversely, for Keystone and that portion of the public who are its shareholders to be left with an asset on which no return and no depreciation are to be allowed for purposes of rate-making would mean that it has virtually nothing to show for the taking of its valuable rights to a protected watershed. That result would indeed seem unjust.

Furthermore, we think it pertinent to observe that it is basic to Pennsylvania utility rate law that calculations of rate base must include *all* property rightfully belonging to a utility company which is used and useful in service to the public. See *Scranton v. Scranton Steam Heat Co.*, 405 Pa. 397, 401, 176 A. 2d 86, 88 (1961); *Lower Paxton Township v. Pa. P. U. C.*, 13 Pa. Cmwlth. 135, 140, 317 A. 2d 917, 920 (1974). This is so irrespective of the source or cost of the property. Thus, in *Scranton, supra,* our Court held that the PUC erred in valuing a steam heating plant at the fortuitous price the utility paid to acquire it; the much higher original cost of construction and the even higher cost of present reproduction were to be considered as well. 405 Pa. at 402-03. Similarly, in *Beaver Valley Water Co. v. Public Service Commission,* 76 Pa. Super. 255, 263-64 (1921), it was held that the fact that the source of funds for the construction of a dam abutment was furnished by a third person was irrelevant to rate base valuation: "It matters not who paid for it if it forms part of appellant's plant and is used in connection

with the public service. It is no part of our duty to measure the value of the consideration given by appellant under said agreement." See also *Peoples Natural Gas Co. v. Pa. P. U. C.*, 153 Pa. Super. 475, 34 A. 2d 375 (1943); *Borough of Lewistown v. Public Service Commission*, 80 Pa. Super. 528 (1923).[9]

In the present case, the utility's filtration plant is devoted to providing adequate water service to the public. That the capital invested in that facility is traceable to a payment of damages for injury to the company's water supply is immaterial for rate-setting purposes.[10] We conclude, therefore, that the value of this item of Keystone's utility property must be restored to rate base and must be considered for purposes of calculating depreciation expense. See *Scranton, supra* at 403-04.[11]

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9. The PUC would have us view the facts in this case as analagous to a situation where the utility constructs a facility with funds donated by its own customers. The Commission has in its own adjudications held that such a facility is excludable from rate base. See, *e.g.*, *P. U. C. v. Pa. Power & Light Co.*, 34 P. U. C. 581, 14 P. U. R. 3d 438 (1956). Suffice it to say that the utility in this case has received a "donation" from neither its customers nor anyone else.

10. Indeed, prior to this case, the P. U. C. has specifically so held. See *McCarney v. Rouzerville Water Co.*, 1 P. U. R. 3d 204 (1953); *Burgettstown v. West Penn Water Co.*, 29 P. U. C. 410 (1951).

11. The PUC argues that the order of the Commonwealth Court must be modified insofar as it directs a remand that does not permit the Commission to reevaluate its finding that 8.5 per cent is the proper rate of return to be applied to rate base. Without such reevaluation, the PUC asserts, the utility company will be permitted annual revenues in excess of the amount it requested.

We are unable to agree that such a modification is appropriate. The issue before the PUC is limited to the tariff supplement filed by the utility. *See* Sec. 308 of the Public Utility Law, *supra*, 66

II.

To put in context the Commission's principal argument in this case, it is helpful to review briefly some first principles of utility rate adjudication in Pennsylvania. In the first place, Section 301 of the Public Utility Law, *supra*, 66 P. S. § 1141, sets forth the fundamental criterion that "[e]very rate made, demanded, or received by any public utility . . . shall be just and reasonable." Our courts have consistently held that the process of implementing this standard and determining allowable revenues upon which customer rates are founded is one of calculating the fair value of a utility's property used and useful in public service (termed the "rate base") and multiplying that amount by a percentage figure called "rate of return" (most frequently determined by reference to the company's cost of capital). See, *e.g.*, *Scranton, supra; Lower Paxton Township, supra; Pittsburgh v. P. U. C.*, 182 Pa. Super. 376, 126 A. 2d 777 (1956).[12] Secondly, with regard to the rate base element, ascertainment of the fair value of utility property has required consideration of two approaches to valuation: original cost of construction and cost of reproducing anew the plant facilities. See *Scranton, supra*, at 402, and cases cited therein.

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11. (Cont'd.)

P. S. § 1148. Furthermore, we note that the 8.5 per cent rate of return found by the Commission was arrived at independently of rate base by careful calculation of Keystone's cost of capital, included embedded cost of long-term debt, preferred stock and common equity. As was pertinently stated in *Pittsburgh v. Pa. P. U. C.*, 158 Pa. Super. 229, 240, 44 A. 2d 614, 618 (1945), "The rate [of return] should not be reduced merely to compensate for a relatively high finding of fair value [of rate base]."

12. The third factor entering into rate adjudication is determination of recoverable operating expenses such as maintenance, depreciation and taxes. See generally, 1 A. PRIEST, PRINCIPLES OF PUBLIC UTILITY REGULATION 45-138 (1969).

These two precepts, the first relating to the overall method to be used for setting rates and the second to the particular meaning accorded to the term "fair value", have their roots in federal constitutional law. "Rates which are not sufficient to yield a reasonable return on the value of the property used . . . are . . . confiscatory, and their enforcement deprives the public utility company of its property in violation of the 14th Amendment." *Bluefield Water Works v. Public Service Commission*, 262 U. S. 679, 690, 67 L. Ed. 1176, 1181 (1923). "And in order to ascertain that value, the original cost of construction . . . [and] the present as compared with the original cost of construction . . . are all factors to be considered." *Id.* (quoting *Smyth v. Ames*, 168 U. S. 466, 42 L. Ed. 819 (1898)).

As we understand its position, the Public Utility Commission now contends that it is not constrained by the above-outlined rate base/rate of return adjudicatory formula (and thus is free to give no specific consideration to Keystone's filtration plant as an element of rate base) where the end result, *i.e.*, the revenues permitted to be received by the utility, may be deemed to be just and reasonable. This approach is valid, we are told, because the Supreme Court of the United States has effectively overruled *Bluefield, supra*, by holding that it is the result reached, and not the method employed, which is controlling for purposes of constitutional inquiry. See *Federal Power Commission v. Hope Natural Gas*, 320 U. S. 591, 88 L. Ed. 333 (1944); *Federal Power Commission v. Natural Gas Pipeline*, 315 U. S. 575, 86 L. Ed. 1037 (1942); cf. *Permian Basin Rate Cases*, 390 U. S. 747, 20 L. Ed. 2d 312 (1968). The Commission cites the following from *Hope, supra*:

> "Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks

> assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the so-called 'fair value' rate base." *Id.* at 605.

Since Keystone has allegedly failed to demonstrate that the PUC's order will impair its financial integrity, *etc.*, the Commission asserts that there has been no error in this case.

We must disagree. Even assuming that the PUC correctly read the Supreme Court's *Hope* decision,[13] our courts have held that the rate base method of rate-setting is mandated by our statutory law, irrespective of whether the federal constitution would require as much. See *Peoples Natural Gas Co. v. Pa. P. U. C.*, 153 Pa. Super. 475, 488-89, 34 A. 2d 375, 382 (1943); *Pittsburgh v. Pa. P. U. C.*, 158 Pa. Super. 229, 235-36, 44 A. 2d 614, 616-17 (1945). The legislative intent to prescribe the rate base technique can be garnered from several sections of our Public Utility Law.[14] We are of the view, furthermore,

13. As we read *Hope* in its entirety, the constitutional issue therein was limited to a consideration of the above-discussed "fair value" definition of rate base, not the use of the rate base method itself (which was in fact followed by the Federal Power Commission in that case).

14. Section 311 of the Public Utility Law, 66 P. S. § 1151 provides:

> "The commission may, after reasonable notice and hearing, ascertain and *fix the fair value of the whole or any part of the property of any public utility*, in so far as the same is material to the exercise of the jurisdiction of the commission, and may make revaluations from time to time and ascertain the fair value of all new construction, extensions, and additions to the property of any public utility. When any public utility furnishes more than one of the different types of utility service enumerated in paragraph seventeen of section two of this act, the commission shall segregate the property used and useful in furnishing each type of such service, and shall not consider

that sanctioning of a free-form "end result" approach to rate-making would be unwise policy. Absent the legal standards implicit in the present rate base/rate of return model, a Commission order and judicial review thereof would be transformed into an uncertain groping for the elusive standards of "justness" and "reasonableness" (or the equally vague factors identified in the quoted

14. (Cont'd.)

the property of such public utility for the purpose of fixing rates." (Emphasis added.)

Section 310(d), 66 P. S. § 1150(d), states:

"Whenever the commission, upon examination of any annual or other report, or of any papers, records, books, or documents, or of the property of any public utility, shall be of opinion that any rates of such public utility are producing *a return in excess of a fair return upon the fair value of the property of such public utility, used and useful in its public service*, the commission may, by order, prescribe for a trial period of at least six months, which trial period may be extended for one additional period of six months, such temporary rates to be observed by such public utility as, in the opinion of the commission, *will produce a fair return upon such fair value*, and the rates so prescribed shall become effective upon the date specified in the order of the commission. Such rates, so prescribed, shall become permanent at the end of such trial period, or extension thereof, unless at any time during such trial period, or extension thereof, the public utility involved shall complain to the commission that the rates so prescribed are unjust or unreasonable. Upon such complaint, the commission, after hearing, shall determine the issues involved, and pending final determination the rates so prescribed shall remain in effect." (Emphasis added.)

See also § 310(a), 66 P. S. § 1150(a).

We note that the PUC purported to follow in the present case the rate base/rate of return formula, stating in its order that "Pennsylvania regulatory law *requires* that consideration be given to measures of value [of a utility company's plant] . . . . " (Emphasis added.)

passage from *Hope, supra*). While the judgment of the Commission is entitled to great weight, it should not be effectively conclusive upon a reviewing court. We think it would become so if the ephemeral approach now advocated were to prevail. It is for this reason that several other courts, and commentators as well, have rejected the suggestion that the rate base technique be abandoned. See *Iowa-Illinois Gas & Electric Co. v. City of Fort Dodge*, 248 Iowa 1201, 85 N. W. 2d 28 (1957); *Illinois Bell Telephone Co. v. Ill. Commerce Commission*, 414 Ill. 275, 111 N. E. 2d 329 (1953); *Petition of New England Tel. & Tel. Co.*, 115 Vt. 494, 66 A. 2d 135 (1949); *Commonwealth Telephone Co. v. Public Service Commission*, 252 Wis. 481, 32 N. W. 2d 247 (1948); E. McKeage, Public Utility Law Regulation 74-80 (1956); Priest, *supra*, at 139-190; Joslin & Miller, "Public Utility Rate Regulation: a Re-Examination", 43 Va. L. Rev. 1027, 1031-1049 (1957); Rose, "Valuation for Rate-making", 47 Minn. L. Rev. 1, 25 (1962); Welch, "Rate Base is Here to Stay!", 52 Pub. Util. Fort. 635 (1953); *Contra, City of Detroit, Michigan v. Federal Power Commission*, 230 F. 2d 810 (D. C. Cir. 1955).[15]

15. The opinion in support of reversal seems to assume that the principal issue in this appeal is the continued vitality of the so-called "fair value" concept as a means of determining valuation of the property of a public utility for rate making purposes. See *Scranton v. Scranton Steam Heat Co., supra*, 405 Pa. at 401. We think the other opinion misperceives the issue. The issue is the continued vitality of the rate base/rate of return adjudicatory formula as the approach to ascertaining just and reasonable rates for public utilities to charge. That formula requires the inclusion of the utility's properties in rate basis at a proper value. In Pennsylvania that value has been denominated in a short-cut fashion as "fair value". See *Scranton, supra*. But in the case at bar the Public Utility Commission totally ignored the utility's filtration plant in its determination of rate base, giving it a zero valuation.

We realize, of course, that our traditional approach to rate-making has not reached the status of a science and that some pragmatic weighting of various factors is necessarily involved. We remain unpersuaded, however, that, abandonment of the rate-base approach and the concept of fair return based thereon would be useful or helpful in the complicated process of utility rate-making, or that such a change in our law and practice is required in the public interest. We therefore must reject the Commission's argument that the value of Keystone's new purification plant can be ignored in the setting of its water rates.

We would affirm the order of the Commonwealth Court.

Mr. Justice O'Brien and Mr. Justice Manderino join in this opinion.

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15. (Cont'd.)

In attempted justification, it argues that the traditional formula heretofore used in utility rate making in Pennsylvania is no longer viable, but must give way to some other approach to just and reasonable rates. That is the issue presented in the case, directed solely to what rate will allow the utility to operate successfully.

IN THE
SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

No. 46 May Term, 1976

KEYSTONE WATER COMPANY,
WHITE DEER DISTRICT

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

Appeal from Order of the Commonwealth Court of Pennsylvania, dated May 27, 1975, at No. 633 C. D. of 1974.

Opinion in Support of Reversal and Reinstatement of the Order of the PUC

ROBERTS, *J.* FILED: April 7, 1978

Today the Opinion of Mr. Justice Pomeroy grants appellee Keystone Water Company the right to reap from its customers—industrial, municipal, and individual—an unjustified bonanza of rate increases. The Opinion of Mr. Justice Pomeroy accomplishes this unfortunate result by requiring appellant Public Utilities Commission to permit Keystone Water to include in its rate base a $1.3 million water filtration plant paid for by the public, and not Keystone Water.

The Opinion of Mr. Justice Pomeroy justifies the inclusion of the publicly funded plant in Keystone Water's rate base by dusting off the outmoded, unworkable "fair value" rule of ratemaking discarded nearly forty years ago

by the federal courts and likewise rejected by the vast majority of state courts and then by requiring the PUC to adhere strictly to the "fair value" rule despite the PUC's statutory authority to utilize any ratemaking device which will produce "just and reasonable" rates. The Opinion of Mr. Justice Pomeroy utilization of the "fair value" rule permits Keystone Water to charge arbitrary, fluctuating, and inflationary rates based on the hypothetical current market value of Keystone Water's original investments, rather than the accurate, predictable rates, based on Keystone Water's actual investments, produced by a "just and reasonable" standard.

Even worse, the Opinion of Mr. Justice Pomeroy misapplies the "fair value" rule by treating the publicly funded water filtration plant as a capital expenditure of Keystone Water, thus allowing depreciation on the publicly funded structure. Even the "fair value" rule does not permit such an extreme windfall. The Opinion of Mr. Justice Pomeroy's extraordinary application of the unwise and roundly rejected "fair value" rule, the misconception of the proper treatment of the publicly funded water filtration plant, and the second-guessing of the PUC compels dissent.

I

The PUC Properly Disallowed Keystone Water's Extravagant Rate Increase

For over seventy-five years, Keystone Water has provided water to residents of Northumberland and Union Counties. Keystone Water has a current capacity of nearly three million gallons and supplies approximately 7,500 customers.

At the turn of the century Keystone Water acquired realty and water rights comprising the White Deer Creek Basin. Water from White Deer Creek, one of Keystone

Water's three principal sources of supply, was so pure that only chlorination was required before delivery to Keystone Water's distribution system. In 1968, however, the Commonwealth constructed Interstate Route 80 through a portion of the creek's watershed, interfering with the purity of the creek. The Pennsylvania Department of Health determined that Keystone Water would have to filter the water from White Deer Creek to maintain its potability. The Commonwealth paid Keystone Water $1,300,000 for the taking of watershed property and injury to the water supply. Keystone Water used this public payment to construct a water treatment plant. Keystone Water now wants the PUC to treat the publicly funded water filtration plant as though Keystone Water, rather than the public, paid for it. It is on this theory that Keystone Water claims a right to include the plant in its rate base and to charge its customers for depreciation.

On August 31, 1972, Keystone Water filed with the PUC a supplement to its schedule of rates, seeking approval of a 48% increase in annual operating revenues, from $865,814 to $1,281,291.[1] Keystone Water proposed that the rates become effective November 1, 1972, but later voluntarily postponed the effective date until November 22, 1972.

On November 20, 1972, the PUC suspended Keystone Water's supplement for six months.[2] On May 21, 1973, the PUC suspended the supplement for another three months to August 22, 1973,[3] to hold hearings on complaints filed by customers of Keystone Water alleging that the

1. The supplement was required by the Public Utility Law, Act of May 28, 1937, P. L. 1053, § 308(a), 66 P. S. § 1148(a) (1959). See Part IIA infra.

2. Such suspensions are authorized by the Public Utility Law, § 308(b), 66 P. S. § 1148(b).

3. See id.

proposed rate increase was unjust, unreasonable, and discriminatory. The PUC ordered on August 17, 1973 that rates existing before Keystone Water filed its supplement remain in force pending determination of the proposed rate increase.[4] The PUC heard argument on February 20, 1974.

On April 17, 1974, the PUC entered an order rejecting $57,906 of Keystone Water's proposed rate increase as unwarranted. The PUC concluded that Keystone Water improperly included the publicly funded White Deer Creek water filtration plant as an asset for purposes of rate-making:

> "For rate-making purposes, we cannot permit respondent to receive all of the salutary effects of the land condemnation and pass them on to the stockholders while passing on all of the deleterious effects of the condemnation to the rate-payers. Clearly, it was not the bare value of the land, in vacuo, for which $1,300,000 was paid as compensation by the Commonwealth. By far, the greater amount of the payment resulted and stemmed from consideration of the land's dedication to public use as a water utility, and recognition of the injury to the interests of the water utility customers. Apparently, the customers of White Deer quite properly were recognized by the parties to the agreement as being in the nature of a third party beneficiaries whose interest in public utility water service had been injured; and accordingly, it was agreed by the parties that to heal the injury to the interests of the customers and restore the former usefulness of the land, i.e., to restore the pre-condemnation status quo as nearly as possible, the filtration plant must be provided for the customers.

4. See id.; id., § 310, 66 P. S. § 1150.

> To reflect equitably and meaningfully this near restoration of, or equitable substitution for, the pre-condemnation status quo, both the utility and its customers must be made whole insofar as reasonably possible. This we have done. As a result of our treatment of the condemnation proceedings, the customers' rates remain unchanged by the condemnation and respondent's financial stability and ability to serve remain unchanged."

Following its long-standing policy of refusing to allow a utility to gain unjustifiably by charging customers for depreciation of property not acquired by capital expenditures, the PUC also denied that part of Keystone Water's rate increase based on depreciation of the water filtration plant.

Keystone Water appealed the order of the PUC to the Commonwealth Court, contending that the PUC erroneously excluded the filtration plant and depreciation on the plant from Keystone Water's rate base. The Commonwealth Court reversed and remanded with instructions that the PUC amend its calculation of the rate base to include the "fair value" and depreciation of the filtration plant whose construction was publicly funded.

II

The Opinion of Mr. Justice Pomeroy Reads the Public Utility Law Out of Context, Ignores the Federal Experience With Judicial Review of Rate Determinations, and Mandates the PUC to Approve Rates Detrimental to all Customers

The Opinion of Mr. Justice Pomeroy affirms the decision of the Commonwealth Court on the ground that the "fair value" rule is required by the Public Utility Law, §§ 310(d) and 311, 66 P. S. §§ 1150(d) and 1151. In the

context of the PUC's rate-making functions, however, the Opinion of Mr. Justice Pomeroy's interpretation of these sections is wholly implausible. "Fair value," as commonly defined, see infra note 7, requires regulatory bodies to allow utilities to charge rates reflecting a return on the assumed cost of reproducing a utility's property. Experience has shown that the Opinion of Mr. Justice Pomeroy's adoption of this rule as a matter of state administrative law will cause unending and unnecessary fluctuations in rate structures, unending judicial involvement with rate determinations, and unjustifiably high rates, to the great detriment of all customers of a utility.

A

The Public Utility Law Requires the PUC to Set "Just and Reasonable" Rates, and Not Rates Based on "Fair Value"

The Public Utility Law defines persons or corporations owning or operating equipment in the Commonwealth and engaging in certain activities as "public utilities," Public Utility Law, § 2(17), as amended, 66 P. S. § 1102(17), and subjects these utilities to regulation by the PUC. Id., § 201, 66 P. S. § 1121. The Law vests in the PUC general administrative powers and requires the PUC to "enforce, execute, and carry out" the Law. Id., §§ 901 and 902, 66 P. S. §§ 1341 and 1342.

The Law prescribes a standard of justness and reasonableness for every rate of public utilities. Section 301 provides:

> "*Rates to be just and reasonable*
>
> Every rate made, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable, and in conformity with regulations or orders of the commission. . . ."

Id., § 301, 66 P. S. § 1141. Utilities must adhere to the schedule of rates approved by the PUC, id., § 303, 66 P. S. § 1143, may not discriminate against persons, corporations, or municipal corporations in fixing rates, id., § 304, 66 P. S. § 1144, and cannot demand advance payment of rates from customers, id., § 305, 66 P. S. § 1145.

Section 309 of the Law, 66 P. S. § 1149, requires the PUC to determine the "just and reasonable" rates to be charged by a public utility whenever it finds, either upon its own motion or upon complaint, that existing rates are unjust or unreasonable.[5] The Law also provides that the PUC may conduct an investigation of proposed changes in rates to determine whether such rates are just and reasonable. Id., § 308(c), 66 P. S. § 1148(c).[6] The Law places upon the public utility the burden of proving the justness and reasonableness of proposed increases in rates, id., § 312, 66 P. S. § 1152, and empowers the PUC to order a public utility to refund to customers the difference be-

5. Section 309 provides:

"Whenever the commission, after reasonable notice and hearing, upon its own motion or upon complaint, finds that the existing rates of any public utility for any service are unjust, unreasonable, or in anywise in violation of any provision of law, the commission shall determine the just and reasonable rates (including maximum or minimum rates) to be thereafter observed and in force, and shall fix the same by order to be served upon the public utility, and such rates shall constitute the legal rates of the public utility until changed as provided in this act."

6. Section 308(c) provides:

"If, after such hearing, the commission finds any such rate to be unjust or unreasonable, or in anywise in violation of law, the commission shall determine the just and reasonable rate to be charged or applied by the public utility for the service in question, and shall fix the same by order to be served upon the public utility; and such rate shall thereafter be observed until changed as provided by this act."

tween rates charged and rates which are "just and reasonable," with interest. Id., § 313(a), 66 P. S. § 1153(a).

The Law also authorizes the PUC to fix temporary rates in either of two principal manners. If the PUC, during rate proceedings brought either by the PUC or upon complaint, determines that the public interest so requires, it may establish a temporary rate of return of no less than five per cent per year on the original cost less depreciation of physical property devoted to public use. Id., § 310(a), 66 P. S. § 1150(a). Second, if upon examination of reports or other documents, the PUC determines that existing rates produce a rate of return in excess of "a fair return upon the fair value of the property of such public utility" devoted to public use, the PUC may for a trial period of up to twelve months reduce existing rates to what it determines to be a fair return. Id., § 310(d), 66 P. S. § 1150(d). Rates so prescribed "shall become permanent at the end of such trial period . . . unless at any time during such trial period . . . the public utility involved shall complain to the commission that the rates so prescribed are unjust or unreasonable."

Thus, the Legislature has authorized the PUC to lower rates temporarily to account for reduced market worth of a utility's property. Rates so lowered by the PUC may be challenged only on the ground that they are not "just and reasonable."

The Opinion of Mr. Justice Pomeroy's reliance upon Section 310(d) is unjustified. This section does not require, as the Opinion of Mr. Justice Pomeroy does, that the PUC utilize "fair value" principles in every instance; it merely authorizes the PUC to lower rates whenever it deems those rates excessive in light of changed economic circumstances. Nor does Section 311, 66 P. S. § 1151, in any fashion support the Opinion of Mr. Justice Pomeroy. Section 311 provides:

"*Valuation of property of a public utility*

The commission may, after reasonable notice and hearing, ascertain and fix the fair value of the whole or any part of the property of any public utility, in so far as the same is material to the exercise of the jurisdiction of the commission, and may make revaluations from time to time and ascertain the fair value of all new construction, extensions, and additions to the property of any public utility. When any public utility furnishes more than one of the different types of utility service enumerated in paragraph seventeen of section two of this act [66 P. S. § 1102(17)], the commission shall segregate the property used and useful in furnishing each type of such service, and shall not consider the property of such public utility as a unit in determining the value of the property of such public utility for the purpose of fixing rates."

Id., § 311, 66 P. S. § 1151. This provision, like Section 310(d), 66 P. S. § 1150(d), authorizes the PUC to determine the fair value of any portion of the property of a public utility. These provisions confer upon the PUC authority to resort to "fair value" principles; "fair value" is not, however, the sole tool available to the PUC for purposes of valuation. Viewed with the Law's "just and reasonable" mandate, these sections indicate a legislative judgment that "fair value" be only one permissible means of appraisal. The Legislature did not intend "fair value" to be used—as the Opinion of Mr. Justice Pomeroy uses it—to create rates of maximum proportions.

The Opinion of Mr. Justice Pomeroy's interpretation is contrary to recent commentary. See C. Pontz & S. Sheller, "The Consumer Interest—Is It Being Protected By The Public Utility Commission?," 45 Temp. L. Q. 315 (1972). The authors conclude:

> "[W]hen the Commission, in investigating existing utility rates, is of the opinion that rates are excessive, it may prescribe temporary rates intended to produce a fair return upon fair value. However, when the Commission is investigating proposed changes in rates, a fair value standard should not be considered a statutory mandate."

Id. at 323 (footnotes omitted). As the authors emphasize, the PUC is not bound by the "fair value" rule, but rather the PUC is to ensure just and reasonable results.

B

The Opinion of Mr. Justice Pomeroy Interprets the Public Utility Law Contrary to the Weight of Federal and State Authority

The rate-setting mechanism established by the Public Utility Law resembles closely the statutory scheme analyzed in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U. S. 591, 64 S. Ct. 281 (1944). The Natural Gas Act, 15 U. S. C. A. §§ 717—717u (1976), vests the Federal Power Commission with jurisdiction over the transmission of gas in interstate commerce. Section 717c(a) of the Act provides that all rates and charges made for the transportation or sale of natural gas subject to the jurisdiction of the FPC "shall be just and reasonable, and any such rate or charge that is not just and reasonable" is unlawful. Section 717d(a) authorizes the FPC to determine what constitutes just and reasonable rates, and to reduce such rates whenever they "are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates." Section 717e(a) provides that the FPC "may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary

for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property."

In assessing the proper rate base of the company, the FPC refused to consider either the cost of reproduction, estimated by the company at $97,000,000, or the "trended original cost," estimated, after depreciation, at $66,000,000. The FPC instead found the proper rate base to be $33,700,000, the "actual legitimate cost." On petition for review to the court of appeals, the company contended that the rates based on actual legitimate costs were confiscatory and unreasonable. The court of appeals agreed, concluding an actual legitimate cost basis could not produce a fair return to the company.

In reversing, the Supreme Court concluded:

"Rate-making is indeed but one species of price-fixing. Munn v. Illinois, 94 U. S. 113, 24 L. Ed. 77 (1877). The fixing of prices, like any other applications of the police power may reduce the value of the property which is being regulated. But the fact that the value is reduced does not mean that the regulation is invalid. Block v. Hirsh, 256 U. S. 135, 41 S. Ct. 458 (1921); Nebbia v. New York, 291 U. S. 502, 54 S. Ct. 505 (1934). . . . It does, however, indicate that 'fair value' is the end product of the process of rate-making not the starting point as the Circuit Court of Appeals held. The heart of the matter is that rates cannot be made to depend upon 'fair value' when the value of the going enterprise depends on earnings under whatever rates may be anticipated.

We held in Federal Power Commission v. Natural Gas Pipe Line Co., supra, that the Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its

> rate-making function, moreover, involves the making of 'pragmatic adjustments.' Id. at 586, 62 S. Ct. at 743. And when the Commission's order is challenged in the courts, the question is whether that order 'viewed in its entirety' meets the requirements of the Act. Id. Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. . . . It is not theory but the impact of the rate order which counts. *If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.* The fact that the method employed to reach that result may contain infirmities is not then important. Moreover, the Commission's order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity. And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences."

Federal Power Commission v. Hope Natural Gas Co., supra at 601-602, 64 S. Ct. at 287-88 (footnote omitted; emphasis added).

"[T]he 'fair value' concept no longer rules the rate-making process and with its demise the area of dispute about 'confiscation' has shrunken to the vanishing point." W. Gellhorn & C. Byse, Administrative Law 415 (1974). See e.g., *Federal Power Commission v. Texaco, Inc.*, 417 U. S. 380, 94 S. Ct. 2315 (1974); *Federal Power Commission v. Memphis Light, Gas & Water Division*, 411 U. S. 458, 93 S. Ct. 426 (1973); *Permian Basin Area Rate Cases*, 390 U. S. 747, 88 S. Ct. 1344 (1968). See also G. Gunther, Constitutional Law, 555 (9th ed. 1975); J. Rose, "The Hope Case and Public Utility Valuation in

the States," 54 Colum. L. Rev. 188 (1954); Cook, "History of Rate Determination Under the Due Process Clause," 11 U. Chi. L. Rev. 297 (1944); Hale, "Utility Regulation in the Light of the Hope Natural Gas Case," 44 Colum. L. Rev. 488 (1944); Harbeson, "The Demise of Fair Value," 42 Mich. L. Rev. 1049 (1944). Moreover, the vast majority of state courts have likewise abandoned the fair value rule as a matter of state administrative law. See W. Gellhorn & C. Byse, Administrative Law, supra; W. Jones, Regulated Industries 110-11 (2d ed. 1976); J. Rose, "Confusion in Valuation for Public Utility Rate-Making," 47 Minn. L. Rev. 1 (1962); J. Rose, "The Hope Case and Public Utility Valuation in the States," supra.

Thus the Supreme Court has held, despite the reference to "fair value" in the Natural Gas Act, that the relevant inquiry under the Act is whether the rate determination of the FPC is a "just and reasonable" one. In holding that the FPC's use of actual legitimate cost of a company's assets as a basis for determining rates satisfies both the governing statutory scheme and the Constitution, *Hope* overruled a long line of cases, beginning with *Smyth v. Ames*, 169 U. S. 466, 18 S. Ct. 418 (1898), which required regulatory bodies, as a matter of constitutional law, to allow utilities to earn a "fair return" on the cost of reproducing assets.[7]

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7. In *Smyth v. Ames*, 169 U. S. 466, 18 S. Ct. 418 (1898), the Court affirmed the decrees of the circuit court enjoining officials of railroad companies doing business in Nebraska from complying with a Nebraska statute fixing the maximum rates those companies could charge. The decrees, sought by shareholders of the companies, also enjoined Nebraska officials from enforcing the statute. The Court concluded that the statute denied the company the opportunity to earn a reasonable return on the "fair value" of its business:

> "We hold . . . that the basis of all calculations as to the reasonableness of rates to be charged by a corporation main-

7. (Cont'd)

taining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And, in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth."

Id. at —, 18 S. Ct. at 434. By the end of World War I, the "fair value" rule entitled a utility to earn a reasonable return on the cost of reproducing assets. See *Utah Power & Light Co. v. Public Service Commission*, 107 Utah 155, 152 P. 2d 542 (1944); J. Rose, "The Hope Case and Public Utility Valuation in the States," 54 Colum. L. Rev. 188 (1954).

Justice Butler, writing for the Court in *McCardle v. Indianapolis Water Co.*, 272 U. S. 400, 410, 47 S. Ct. 144, 148 (1926), in an era when the Court was "wholeheartedly in the business of scrutinizing the reasonableness of rates," G. Gunther, Constitutional Law 555 (9th ed. 1975), declared the governing principle of the day: "It is well established that values of utility properties fluctuate, and that owners must bear the decline and are entitled to the increase." Accordingly, the rule sometimes prohibited regulated companies from passing along to consumers the unfavorable effects of excessive investments, e.g., *San Diego Land & Town Co. v. Jasper*, 189 U. S. 439, 23 S. Ct. 571 (1903); *San Diego Land & Town Co. v. City of National City*, 174 U. S. 739, 19 S. Ct. 804 (1899), and other times allowed regulated companies to benefit from the effects of inflation on original investments, e.g., *McCardle v. Indaianapolis Water Co.*, 272 U. S. 400, 47 S. Ct. 144 (1926); *Bluefield Water Works & Improvement Co. v. Public Service Commission*, 262 U. S. 679, 43 S. Ct. 675 (1923).

By replacing the cost of reproduction standard associated with "fair value" with a standard allowing regulatory bodies to set rates based on a utility's actual, legitimate investment, the Court acknowledged the shortcomings of the "fair value" rule. As Justice Brandeis demonstrated, the rule produced arbitrary and fluctuating results:

> "The Constitution does not guarantee to the utility the opportunity to earn a return on the value of all items of property used by the utility or of any of them. The several items of property constituting the utility, taken singly, and freed from the public use, may conceivably have an aggregate value greater than if the items are used in combination. The owner is at liberty, in the absence of controlling statutory provision, to withdraw his property from the public service, and, if he does so, may obtain for it exchange value. . . . But so long as the specific items of property are employed by the utility, their exchange value is not of legal significance.
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> The investor agrees, by embarking capital in a utility, that its charges to the public shall be reasonable. His company is the substitute for the state in the performance of the public service, thus becoming a public servant. The compensation which the Constitution guarantees an opportunity to earn is the reasonable cost of conducting the business. Cost includes, not only operating expenses, but also capital charges. Capital charges cover the allowance, by way of interest, for the use of the capital, whatever the nature of the security issued therefor, the allowance for risk incurred, and enough more to attract capital.
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> • • •

The rule of Smyth v. Ames sets the laborious and baffling task of finding the present value of the utility. It is impossible to find an exchange value for a utility, since utilities, unlike merchandise or land, are not commonly bought and sold in the market. Nor can the present value of the utility be determined by capitalizing its net earnings, since net earnings are determined, in large measure, by the rate which the company will be permitted to charge, and thus the vicious circle would be encountered. So, under the rule of Smyth v. Ames, it is usually sought to prove the present value of a utility by ascertaining what it actually cost to construct and install it, or by estimating what it should have cost, or by estimating what it would cost to reproduce or replace it. To this end an enumeration is made of the component elements of the utility, tangible and intangible; then the actual, or proper, cost of producing, or of reproducing, each part is sought; and finally it is estimated how much less than the new each part, or the whole, is worth. That is, the depreciation is estimated. Obviously each step in the process of estimating the cost of reproduction, or replacement, involves forming an opinion, or exercising judgment, as distinguished from merely ascertaining facts. And this is true, also, of each step in the process of estimating how much less the existing plant is worth than if it were new. There is another potent reason why, under the rule of Smyth v. Ames, the room for difference in opinion as to the present value of a utility is so wide. The rule does not measure the present value either by what the utility cost to produce, or by what it would cost to reproduce, or to replace it. Under that rule the tribunal is directed, in forming its judgment, to take into consideration all those and also other elements, called relevant facts.

> Obviously, 'value' cannot be a composite of all these elements. Nor can it be arrived at on all these bases. They are very different, and must, when applied in a particular case, lead to widely different results. The rule of Smyth v. Ames, as interpreted and applied, means merely that all must be considered. What, if any, weight shall be given to any one, must practically rest in the judicial discretion of the tribunal which makes the determination. Whether a desired result is reached may depend upon how any one of many elements is treated. It is true that the decision is usually rested largely upon records of financial transactions, on statistics and calculations. But as stated in Louisville v. Cumberland Telegraph & Telephone Co., 225 U. S. 430, 436, 32 S. Ct. 741, 742 'every figure * * * that we have set down with delusive exactness' is 'speculative.'"

Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission, 262 U. S. 276, 290-296, 43 S. Ct. 544, 547-49 (1923) (Brandeis, J., joined by Holmes, J., concurring) (footnotes omitted).

Justice Frankfurter argued that the "fair value" rule destroyed the proper relations between the judicial and administrative processes by making courts the final ratemakers:

> "The force of reason, confirmed by events, has gradually been rendering [the] formula [of Smyth v. Ames] moribund by revealing it to be useless as a guide for adjudication. Experience has made it overwhelmingly clear that Smyth v. Ames and the uses to which it has been put represented an attempt to erect temporary facts into legal absolutes. The determination of utiltiy rates—what may fairly be exacted from the public and what is adequate to enlist enterprise—

does not present questions of an essentially legal nature in the sense that legal education and lawyers' learning afford peculiar competence for their adjustment. These are matters for the application of whatever knowledge knowledge economics and finance may bring to the practicalities of business enterprise. The only relevant function of law in dealing with this intersection of government and enterprise is to secure observance of those procedural safeguards in the exercise of legislative powers which are the historic foundations of due process.

Mr. Justice Bradley nearly fifty years ago made it clear that the real issue is whether courts or commissions and legislatures are the ultimate arbiters of utility rates (dissenting in Chicago, Milwaukee & St. Paul Ry. Co. v. Minnesota, 134 U. S. 418, 461, 10 S. Ct. 702, 703, 33 L. Ed. 970). Whatever may be thought of the wisdom of a broader judicial role in the controversies between public utilities and the public, there can be no doubt that the tendency, for a time at least, to draw fixed rules of law out of Smyth v. Ames has met the rebuff of facts."

Driscoll v. Edison Light & Power Co., 307 U. S. 104, 122-23, 59 S. Ct. 715, 724 (1939) (Frankfurter, J., joined by Black, J., concurring).[8]

8. Criticism of the fair value rule was unending. See *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U. S. 575, 599, 609, 62 S. Ct. 736, 749, 753 (1942) (Black, Douglas, and Murphy, JJ., concurring; Frankfurter, J., concurring); *McCart v. Indianapolis Water Co.*, 302 U. S. 419, 423, 58 S. Ct. 324, 326 (1938) (Black, J., dissenting); *West v. Chesapeake & Potomac Telephone Co.*, 295 U. S. 662, 680, 55 S. Ct. 894, 901 (1935) (Stone, J., joined by Brandeis and Cardozo, JJ., dissenting); *O'Fallon R. Co. v. United States*, 279 U. S. 461, 488, 548, 49 S. Ct. 384, 389, 409 (1929) (Brandeis, J., joined by Holmes and Stone, JJ., dissenting Stone, J.,

C

The Opinion of Mr. Justice Pomeroy Ignores the Shortcomings of the "Fair Value" Rule

The Opinion of Mr. Justice Pomeroy today gives "new vitality to the mischievous formula" of *Smyth v. Ames*, see id. at 122, 59 S. Ct. at 724 (Frankfurter, J., joined by Black, J., concurring), by holding that the Public Utility Law requires the PUC to employ "fair value." First, by requiring the PUC to allow Keystone Water to charge its customers rates representing a fair return on the fair value of the White Deer Creek water filtration plant, the Opinion of Mr. Justice Pomeroy requires the PUC to permit arbitrary, fluctuating rates artificially insensitive to inflationary pressures. The water filtration plant is the tangible asset needed to preserve the quality of the water from White Deer Creek. The plant replaced Keystone Water's asset of nearly perfect water, which had appreciated over the years Keystone Water had been in business. The cost of the water filtration plant is part of the cost to Keystone Water of reproducing its original investment at current market prices. This cost of reproduction is ever-changing, ever-rising, and has nothing to do with the actual, legitimate cost of what Keystone Water dedicated to the public use. By considering the water filtration plant relevant, the Opinion of Mr. Justice Pomeroy places determination of rates in the hands of the market forces which the clear weight of federal and state authority has determined harmful to rate adjudication.

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8. (Cont'd.)

joined by Holmes and Brandeis, JJ., dissenting); Hale, "Does the Ghost of Smyth v. Ames Still Walk?," 55 Harv. L. Rev. 1116 (1942); Hale, "The 'Fair Value' Merry Go-Round, 1898 to 1938," 33 Ill. L. Rev. 517 (1939); Richberg, "Value—By Judicial Fiat," 40 Harv. L. Rev. 567 (1927).

Keystone Water's rates are already sensitive to the inflationary pressures on the cost of new capital investment, labor, chemicals, and other supplies used in purification and delivery of water. Keystone Water may properly increase rates to reflect such increased costs because it incurs these costs in serving customers. Customers should not, however, have to bear the additional burden of inflated, hypothetical costs, not incurred in producing and distributing water, but merely in reproducing Keystone Water's original investment. The publicly funded plant, reproducing Keystone Water's original investment therefore cannot be the basis for rate increases.

Second, the Opinion of Mr. Justice Pomeroy revives a long discarded standard for reviewing the PUC's determination of proper rates which places courts in the role of rate-makers. Federal courts have found that judicial review of rate determinations under a standard of "fair value" is a frequent, difficult, and unsatisfactory undertaking. A court can more easily determine whether a regulatory body has acted within its statutory and constitutional authority than whether a rate is fair as a matter of initial rate-making law. Limited judicial inquiry relieves the judicial burden, minimizes the likelihood that a court, unfamiliar with critical nuances of a regulated industry, will reach an incorrect result, and "assure[s] requisite flexibility to the officials or agencies designated to discharge the tasks assigned by the [Legislature]." H. Linde & G. Bunn, Legislative and Administrative Processes 523 (1976), citing *New York Central Securities Corp. v. United States,* 287 U. S. 12, 53 S. Ct. 45 (1932) (permitting consolidation of carriers in the public interest); *Federal Power Commission v. Hope Natural Gas Co.,* supra; *National Broadcasting Co. v. United States,* 319 U. S. 190, 63 S. Ct. 997 (1943) (licensing of radio communications in the public interest); *Lichter v. United States,* 334 U. S. 742, 68

S. Ct. 1294 (1948) (recovery of excessive profits on war contracts).

The Opinion of Mr. Justice Pomeroy also concludes that "fair value" principles are advantageous because they avoid judicial elucidation of what the Opinion of Mr. Justice Pomeroy refers to as the "elusive standards of 'justness' and 'reasonableness.' The Opinion of Mr. Justice Pomeroy fails to disclose, however, by what reasoning "fair value" is less "elusive" than the statutorily prescribed standards of "justness and reasonableness." In choosing between two standards, courts must prefer the modern, prevailing standard in the federal and state courts which avoids perpetual adjustments of rates according to market fluctuations irrelevant to a utility's actual investment, allows the regulatory body to set reasonable rates, and properly circumscribes judicial review. The Opinion of Mr. Justice Pomeroy's standard not only forces the PUC to endorse inflated, unjustified rates, but also returns our courts to the days when the economic thinking of judges governed matters better left to legislatures and regulatory bodies. History has taught too valuable a lesson to be forgotten so quickly, or ignored so unwisely.

All customers, industrial, municipal, and individual, will feel the impact of today's decision enhancing the rate base of Keystone Water. The Opinion of Mr. Justice Pomeroy requires the PUC to approve rates reflecting hypothetical increases in the current market value of a utility's property attributable to presumed changes in market conditions, even in an inflationary economy. Thus, the Opinion of Mr. Justice Pomeroy compels customers to pay a utility a higher rate even where the utility has not increased its capital investment, but only its hypothetical value. Utility customers should not be subjected to such unjustified hardship. See *Duquesne Light Co. v. Borough*

of Monroeville, 449 Pa. 573, 582, 298 A. 2d 252, 257 (1972) (Roberts, J., concurring).

The Public Utility Law's emphasis on the "justness and reasonableness" of rates clearly establishes that whether rates are "just and reasonable" is the sole concern of courts of this Commonwealth in reviewing rate determinations of the PUC. The Opinion of Mr. Justice Pomeroy refuses to draw from the Supreme Court's interpretation of the federal analogue of the Public Utility Law that "justness and reasonableness," rather than "fair value," is the governing principle in rate-making cases.

III

Even the "Fair Value" Rule Does Not Condone the Opinion of Mr. Justice Pomeroy's Grant of Today's Huge Windfall

Even assuming that the already disavowed "fair value" rule is the standard for determining utility rates, the Opinion of Mr. Justice Pomeroy has erroneously applied that standard. Before the Commonwealth's condemnation, Keystone Water would have been entitled to a fair return on the cost of reproducing its original investment in the White Deer Creek watershed. This cost would include replacement of a source of water so pure that only chlorination would be required before delivery to Keystone Water's distribution system. To reproduce such a resource, Keystone Water would need a source of water, a filtration plant to bring that water up to comparable standards, and money to operate the plant. See Eminent Domain Code, Act of June 22, 1964, P. L. 84, § 602(a), 26 P. S. § 1-602(a) (Supp. 1977).

Accordingly, Keystone Water would be entitled to charge its customers a rate representing a fair return on the value of the source of the water and the filtration plant,

and to recover operating expenses for the plant. The Opinion of Mr. Justice Pomeroy, however, permits Keystone Water much more—(1) to charge a rate reflecting each of these considerations, and (2) depreciation on the water filtration plant. Thus, by the Opinion of Mr. Justice Pomeroy's misapplication of the "fair value" rule, Keystone Water is elevated to a position much superior to that held before the Commonwealth paid Keystone Water $1.3 million, used for the construction of the filtration plant. Keystone Water is now entitled to charge its customers twice for the water filtration plant: once for a fair return on the public investment, and again for its depreciation. Keystone Water, under any theory of rate-setting, should not be permitted to charge its customers depreciation on something it never paid for. The PUC, unlike the Opinion of Mr. Justice Pomeroy, correctly recognized Keystone Water's attempt to secure an extravagant windfall and properly refused to allow the requested rate increase.

IV

The PUC's Determination is Just and Reasonable and Should be Affirmed

The PUC investigated the supplement of Keystone Water requesting rate increases pursuant to the Public Utility Law, § 308, 66 P. S. § 1148. After hearings, investigations, and argument, the PUC determined that the requested rate increase would require customers to pay a rate of return on the publicly financed White Deer Creek water filtration plant. Accordingly, the PUC decided that the requested rate increase should be decreased by excluding the filtration plant from the rate base.

By the terms of Section 308(c) of the Public Utility Law, Keystone Water would be justified in complaining only if the ultimate rate approved by the PUC was not

"just and reasonable." Nothing in the record indicates that the PUC's balancing of the considerations involved in these proceedings was not "just and reasonable." Indeed, the PUC's determination is a proper accommodation of private and public concerns, allowing Keystone Water a just return on its actual investment, and demonstrating a correct and commendable concern for the rate increase's effect on all customers. The PUC correctly refused to allow Keystone Water to charge its customers additional rates based on the publicly funded plant.

The Opinion of Mr. Justice Pomeroy affirms the Commonwealth Court's erroneous reversal of a just and reasonable determination of the PUC. I dissent, would reverse the order of the Commonwealth Court, and would reinstate the order of the PUC.[9]

Mr. Chief Justice EAGEN and Mr. Justice NIX join in this Opinion in Support of Reversal and Reinstatement of the Order of the PUC.

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9. The Opinion of Mr. Justice Pomeroy errs in asserting that the continuing validity of the "fair value" concept is not before us. See slip opinion at 18, n. 15. Only if Keystone Water can charge customers rates based on the cost reproducing original investments can it justify including in its rate base the plant which represents the cost of reproducing its original investment in the White Deer Creek watershed. Keystone Water never paid for the water filtration plant. Because the plant was constructed with public funds, Keystone Water cannot justify including the plant in its rate base on the ground that the plant represents its own capital expenditure.

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No. 80-1917

In the Supreme Court of the United States

October Term, 1980

PENNSYLVANIA GAS AND WATER COMPANY,

Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Respondent.

[35 May Term, 1978]

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF PENNSYLVANIA

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COUNTERSTATEMENT OF THE QUESTIONS PRESENTED

1. Whether the Pennsylvania Public Utility Commission properly determined that the Pennsylvania Gas and Water Company may not receive a return on an investment in facilities constructed with funds contributed by the general public?

2. Whether due process and equal protection of the law requires the Pennsylvania Supreme Court, when confronted by like issues, in discrete cases decided two years apart, is bound by the earlier of two decisions, where the earlier decision only resolved the issues between the parties and was not precedent?

3. Whether due process and equal protection of the law requires that the Pennsylvania Supreme Court decide a civil appeal within a specific time period, where the party asserting those constitutional infirmities has not been prejudiced?

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COUNTERSTATEMENT OF THE CASE

Petitioner, Pennsylvania Gas and Water Company (PG&W), seeks review of a July 9, 1974 Pennsylvania Public Utility Commission (Commission) rate determination, as affirmed by the state's highest court, the Supreme Court of Pennsylvania. A detailed review of the pertinent events of the proceedings below is appropriate before considering the Commission's arguments opposing the grant of a writ of certiorari.

On January 30, 1973, PG&W filed with the Commission a proposed rate increase calculated to produce approximately $4.8 million of additional annual revenues. The increase was requested in two separate stages; the first stage proposed an increase of approximately $2.2 million, and the second proposed an increase of an additional $2.6 million. The Commission permitted the entire first stage to become effective on April 12, 1973; however, the Commission suspended the operation of the second stage of the increase pending an investigation into the merits of both stages of the entire proposed increase.

On July 9, 1974, the Commission issued its final order in the rate investigation, which granted PG&W a rate increase of approximately $4.2 million, *or 87% of the amount requested by the utility.* The allowed rate increase provided the company with the opportunity to earn a 7.35% return on the "fair value" of its plant devoted to the public service, with fair value calculated as $102,000,000, or *149% of $68,288,850, which represents the company's claimed depreciated cost of its water plant.*

This 7.35% rate of return on fair value translated to a 10.98% return on the utility's claimed original cost rate base.

PG&W filed an appeal with an intermediate appellate court, the Commonwealth Court of Pennsylvania. In its appeal, PG&W challenged various Commission determinations, including the fair value and fair rate of return findings. The Commonwealth Court affirmed the July 9, 1974 order of the Commission in regard to all ratemaking issues except one. *Pa. P.U.C. v. Pennsylvania Gas and Water Company*, 19 Pa. Commonwealth Ct. 214, 341 A.2d 239 (1975); this latter opinion and order is reprinted in PG&W's petition for writ of certiorari, Appendix C. The only issue reversed by the intermediate appellate court was a rate base disallowance of approximately $2.5 million, representing utility property constructed with money obtained from a damage settlement payment made to PG&W by the Commonwealth of Pennsylvania, the Pennsylvania Department of Transportation (PennDOT).

The Commission generally agrees with statement of the factual background of the damage payment contained in PG&W's petition. The Commission, however, wishes to emphasize one additional point. In addition to the damage payment received from PennDOT, PG&W invested $243,202 of additional funds for the construction of a pipeline, and $4,122,290 for the construction of the reservoir. The additional funds invested by the company were *included* in PG&W's rate base in the Commission's rate order of July 9, 1974. In addition, the Commission permitted the company to recover its maintenance and operating expenses attributed to the pipeline and reservoir. The Commission, however, disallowed from PG&W's claimed rate base the amount of $2,558,634, representing

the net of the PennDOT payment of $2,754,754, less PG&W's unrecovered investment in the replaced plant. In making this exclusion, the Commission reasoned that PennDOT's payment should be treated for accounting and ratemaking purposes as a contribution in aid of construction in order to balance equitably the interests of the customers and interests of the utility.

As previously noted, on May 27, 1975, the intermediate appellate court reversed the Commission's order with respect to the ratemaking treatment given the PennDOT payment. On the same day, the intermediate appellate court issued another decision reversing a similar ratemaking determination by the Commission in a case involving another utility, the Keystone Water Company. *See Keystone Water Company, White Deer District v. Pa. P.U.C.*, 19 Pa. Commonwealth Ct. 292, 339 A.2d 873 (1975); this decision is also reproduced in PG&W's petition for a writ of certiorari, Appendix E.

On June 26, 1975, the Commission petitioned the Supreme Court of Pennsylvania for allowance of appeals from both lower court decisions involving PG&W and Keystone Water Company, and requested a supersedeas of the lower court's decision in the case involving PG&W. The Pennsylvania Supreme Court granted the Commission's request for an allowance of an appeal from the *Keystone* decision. On April 7, 1978, in *Keystone Water Co., White Deer District v. Pa. P.U.C.*, 477 Pa. 594, 385 A.2d 946 (1978), the Pennsylvania Supreme Court, in a per curiam opinion, affirmed the order of the Commonwealth Court *for the stated reason that the Supreme Court was equally divided on the question involved. See* PG&W's petition for writ of certiorari, Appendix F, p. A93. Less than three months later, on June 21, 1978, the Pennsyl-

vania Supreme Court granted the Commission's petition for allowance of an appeal from the lower court's *PG&W* decision, and on August 11, 1978, the Supreme Court of Pennsylvania granted the Commission's petition for supersedeas of the Commonwealth Court's order in *PG&W*. *See* Appendix A of this brief in opposition to petition for writ of certiorari.

On February 1, 1980, the Supreme Court of Pennsylvania entered a judgment and opinion reversing the Commonwealth Court's decision in *PG&W*, and reinstated the Commission's July 9, 1974 rate determination. On February 24, 1981, the Pennsylvania Supreme Court denied an application for reargument filed by PG&W.

The instant petition for a writ of certiorari is now pending before your Honorable Court.

REASONS FOR DENYING THE WRIT

I. The Pennsylvania Public Utility Commission's Resolution of a Single Issue in a Complex Rate Determination Does Not Raise a Constitutional Question When the Ultimate Rate Result Reached Is Not Challenged as Being Unjust and Unreasonable

If your Honorable Court were to grant the requested writ of certiorari, PG&W proposes to argue first the appropriate ratemaking treatment to be given to the PennDOT damage payment. A review of the applicable precedent reveals that PG&W's first question presented for review raises the same kind of routine ratemaking issue which this Honorable Court, over thirty-six years ago, determined to be beyond the scope of judicial review and inquiry. *See Federal Power Commission v. Hope Natural Gas Company,* 320 U.S. 591 (1944). The Commission decision which PG&W would have this Court review simply does not raise an issue of constitutional proportions; accordingly, there are no special or important reasons for granting a writ of certiorari.

The Commission is a legislative instrumentality performing the Commonwealth of Pennsylvania legislature's exclusive function of exercising the sovereign police power in the regulation of rates and services of public utilities. *See* Act of May 28, 1937, P.L. 1053 (66 P.S. §1101 *et seq.*), *repealed,* now codified as the Public Utility Code, Act of July 1, 1978, P.L. 598, 66 Pa. C.S. §101, *et seq.*

Section 1301 of the Public Utility Code, 66 Pa. C.S. §1301 provides, in pertinent part, that "[e]very rate made, demanded or received by any public utility . . . shall be just and reasonable. . . ." PG&W now seeks to challenge in this Honorable Court the Pennsylvania Supreme Court's affirmance of the Commission's resolution of the proper ratemaking treatment to be afforded the PennDOT damage payment. However, PG&W does *not* challenge the Commission's July 9, 1974 rate determination on the grounds that the *overall result* of the $4.2 million increase allowed is unjust and unreasonable; nor has PG&W contended that the return allowed is insufficient to permit the company to operate successfully, to maintain its financial integrity, to attract capital, or to compensate its investors for the risks assumed.

Specifically, the Commission's position is that since PG&W has not challenged the ultimate rate result reached in the Commission's July 9, 1974 order, no constitutional issue is presented. A review of the decisions of this Court supports the Commission's position.

It is settled that the Fourteenth Amendment to the United States Constitution does not prohibit the states' regulation of the rates to be charged by public utilities, which are private businesses affected with the public interest. *Munn v. Illinois,* 94 U.S. 113 (1876). Of course, the rates fixed for public utilities by the states may be overturned upon judicial review, where those rates are found to be tantamount to a deprivation of the lawful use of private property. *Chicago Milwaukee and St. Paul Ry. v. Minnesota,* 134 U.S. 418 (1890). The troublesome question which concerned your Honorable Court for over half a century was what rate level amounted to a deprivation of the use of private property, or an illegal confiscation.

While various "confiscatory" standards have been expressed,[1] it was established "[b]y long standing usage in the field of rate regulation [that] the 'lowest reasonable rate' [in a zone of reasonableness] is one which is not confiscatory in the constitutional sense." *Federal Power Commission v. Natural Gas Pipeline Co. of America,* 315 U.S. 575, 585 (1942) (citations omitted).

The pertinent question for the judiciary, upon review of a legislative ratemaking determination, is whether the rates established are unconstitutionally low. In *Natural Gas Pipeline Co.,* Chief Justice Stone discussed the narrow scope of judicial review of rates prescribed by the Federal Power Commission:

> The constitution does not bind ratemaking bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances. Once a fair hearing has been given, proper findings made and other statutory requirements satisfied, the courts cannot intervene in the absence of a clear showing that the limits of due process have been overstepped. *If the Commission's order, as applied to the facts before it and viewed in its entirety, produces no arbitrary results, our inquiry is at end.*

Id. at 586. (Emphasis added.)

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[1] For example, in *St. Louis & San Francisco Railway v. Gill,* 156 U.S. 649, 647 (1895), the Court noted that confiscation results where there exists "a tariff of rates which is so unreasonable as to practically destroy the value of property. . . ."

In the landmark case of *Hope Natural Gas Company*, your Honorable Court further delineated the appropriate scope of judicial review of ratemaking determinations. Rates are not confiscatory if they are just and reasonable,[2] and the reasonableness of rates established by a legislative body is to be reviewed by an appellate court under an economic viability standard. Justice Douglas stated:

> [W]hen the Commission's order is challenged in the courts, the question is whether that order 'viewed in its entirety' meets the requirement of the [Natural Gas] Act. . . . Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. . . . It is not theory but the impact of the rate order which counts. *If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.*
>
> * * *
>
> Rates which enable a company to operate successfully, to maintain its financial integrity, to attract capital and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the so-called 'fair value' rate base.

Id. at 602. (Emphasis added.)

Id. at 605.

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[2] In *Hope Natural Gas Company*, this Court found that "[s]ince there are no constitutional requirements more exacting than the [just and reasonable] standards of the [Natural Gas] Act, a rate order which conforms to the latter does not run afoul of the former." *Id.* at 607. As previously noted, the Commission is bound by a similar "just and reasonable" standard in setting rates. *See* 66 Pa. C.S.§1301.

PG&W's request for a writ of certiorari does not contend that the Commission's July 9, 1974 rate order, reinstated by the Pennsylvania Supreme Court, when viewed in its entirety, has rendered the company unable to operate successfully, to maintain financial integrity, to attract capital, or to compensate its investors. Rather, PG&W simply seeks review of a single rate case issue decided adversely to it by the Commission and the state's highest court. It is submitted that no constitutional issue has been raised. *Hope Natural Gas Company.*

PG&W's argument that the effect of the Commission's decision is to give the company's private property to the ratepayer, contrary to this Court's decision in *Board of Utility Commissioners v. New York Telephone Company,* 271 U.S. 23 (1926), lacks merit. Petitioner has stated that "[*h*]*ad PG&W not been a public utility* with a legal duty to render adequate service, the [PennDOT] damage proceeds could have been distributed in the form of dividends to its stockholders." Petition for Writ of Certiorari, P. 8 (emphasis added). Such a statment ignores the very essence of the proper ruling in the court below; *PG&W is a public utility,* and as such it was obligated by law to ensure that adequate service to the City of Scranton was maintained. *See* the Pennsylvania Public Utility Code, 66 Pa. C.S. §1501. Furthermore, PG&W was only able to receive "cost-to-cure" damages of $2,754,754 because of its unique responsibilities as a public utility. *See Pennsylvania Gas and Water Company v. Pennsylvania Turnpike Commission,* 428 Pa. 74, 236 A.2d 112 (1967).

Finally, the decisions below are not contrary to *Board of Utility Commissioners,* which is inapposite. In *Board,* the state commission recognized that its establishment of overall rates was insufficient to yield a reasonable return;

however, the commission's view was that the company's past collection of monies supplied by ratepayers, represented by a credit balance in the depreciation reserve account, could be used to make up the deficiency. This Court rejected the state commission's contentions, holding that: "the law does not require the company to give up for the benefit of future subscribers any part of its accumulations from past operations. Profits of the past cannot be used to sustain confiscatory rates for the future." *Id.* at 32. In the instant case, there is no question that the Commission's July 9, 1974 rate order was based upon the determination of PG&W's *current* revenue requirement.

II. The Action of the Pennsylvania Supreme Court in Reversing the Decision of the Intermediate Appellate Court Did Not Deny the Petitioner Due Process or Equal Protection of Law

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PG&W argues in the second and third reasons for granting the writ that it was denied due process and equal protection of law by the action of the Pennsylvania Supreme Court in reversing the decision of the intermediate appellate court. The Commission respectfully submits that these arguments are unsupported by the law or by the record in this case.

This Honorable Court has previously recognized that the Constitution does not require a state to provide appellate courts, but that when an appeal is permitted, it must meet the requirements of due process and equal protection. *Griffin v. Illinois,* 351 U.S. 12, 18 (1955); *see also Douglas v. California,* 372 U.S. 353 (1963). PG&W exercised its Pennsylvania statutory right of appellate review of the Commission's rate determination by filing an appeal to the

Commonwealth Court of Pennsylvania. Upon reversal by the intermediate appellate court, the Commission sought discretionary review by the state's highest appellate court, the Pennsylvania Supreme Court. It is upon this subsequent review of the intermediate appellate court's decision that PG&W bases its allegations of constitutional infirmity. The Commission respectfully submits that PG&W's arguments in support of its allegations are unpersuasive.

PG&W argues that the time periods associated with the Pennsylvania Supreme Court's decisions to hear the appeal and to issue subsequently an opinion worked a denial of due process and equal protection. PG&W, however, has failed to establish that the delays it complains of were unusual, or that there existed an invidious discrimination by the Pennsylvania Supreme Court. PG&W only has established that the discretionary review procedures of the Pennsylvania Supreme Court may take several years. On this basis, PG&W has failed to support its conclusionary allegations of a denial of due process or equal protection by the Court below.

PG&W's argument is weakened further by an examination of it in the context of the instant case. PG&W is complaining about the time periods associated with an appeal *taken by the Commission* in this matter. Unlike the precedents in the Federal Circuit Courts, which have held that an unjustified delay in an appeal of a criminal conviction can work a denial of due process, *see e.g. United States ex rel. Smith v. Twomey*, 486 F.2d 736 (7th Cir.), *cert. denied* 416 U.S. 994 (1973), PG&W was not the appellant in the appeal it complains of. Moreover, any delays associated with the Commission's appeal to the Pennsylvania Supreme Court were not prejudicial to PG&W in any sense.

The Commonwealth Court reversed the Commission's rate determination by an opinion and order filed May 27, 1975. The Court remanded the matter to the Commission and directed it to amend its determination to recognize the proceeds of the highway damage payment, and to make any associated depreciation adjustments. The Commission complied with this direction in a final order dated July 7, 1976, wherein it concluded a subsequent rate proceeding involving PG&W. The Commission stated in its July 7, 1976 order:

> *In accordance with the Commonwealth Court Order and for the purposes of concluding these present proceedings, we will allow that portion of respondent's property financed by the Commonwealth payment in our determination of fair value. In addition, we will make an appropriate annual depreciation allowance for that property.* However, it is still the opinion of this Commission that the Commonwealth payment is an excludable item from cost of service on the basis of it being a contribution of funds and not funds supplied by the stockholder. Accordingly, on June 26, 1975, the Commission filed a Petition for an Allowance of Appeal of the Commonwealth Court Order with the Pennsylvania Supreme Court. At this time, the Supreme Court has neither granted nor denied this petition. In the event that the Commonwealth Court Order is subsequently reversed and the Supreme Court maintains the Commission's position therein, respondent may be required to refund to customers, with interest, such amounts as are included in the cost of service relative to the facilities financed by the Commonwealth payment. (Emphasis added.)

Therefore, the Commission complied with the direction of the intermediate appellate court even while it pursued its appeal to the Pennsylvania Supreme Court. In this context, the time periods associated with the Commission's further appeal worked no prejudice to PG&W at all, since the contested rate base adjustment had already been accomplished. PG&W's argument that it was subjected to the possibility of refunds lacks merit. The Commission's July 7, 1976 order clearly put PG&W on notice that it could collect the revenues in question only subject to possible refunds; any doubt that PG&W may have had that it was collecting revenues at its peril was removed absolutely by the Pennsylvania Supreme Court's grant of a supersedeas on August 11, 1978. This complete lack of prejudice to PG&W deflates its argument that the time periods associated with the Commission's appeal to the Pennsylvania Supreme Court somehow denied it due process and equal protection of the law.

PG&W also argues that the decision of the Court below in reversing the intermediate appellate court and reinstating the Commission's rate determination was itself a violation of due process and equal protection. As argued by PG&W, "the action of the Court below in rendering two totally inconsistent decisions in appeals filed on the same day, by the same party and involving the same issue is a violation of the Fourteenth Amendment" (footnote omitted). Again, the argument is unsupported by the law or the record in this case. The gravamen of PG&W's argument is that its constitutional rights were violated because the Pennsylvania Supreme Court reached inconsistent results in two appeals presenting similar issues. This argument, distinguished by the absence of specific supporting citation

and by a subtle twisting of the facts, completely lacks merit.

The rate base issue which is raised by PG&W was decided in two opinions issued by the Commonwealth Court on the same day. Both of these opinions reversed rate base determinations made by the Commission. Further review of both cases by the Pennsylvania Supreme Court was sought by the Commission. Although the petitions for allowance of appeal of both cases were filed simultaneously, decisions in the cases by the Pennsylvania Supreme Court were returned several years apart.

In the first case, *Keystone Water Company, White Deer District v. Pennsylvania Public Utility Commission,* 477 Pa. 594, 385 A.2d 946 (1978) (Appendix F in the Petition), the Pennsylvania Supreme Court affirmed, by an equally divided court, the Commonwealth Court's decision that the Respondent's ratemaking exclusion was a violation of due process. In that case, the Court issued three opinions which included a *per curiam* opinion affirming the lower court's decision because of the equally divided court, as well as opinions in support of reversal and affirmance, each subscribed to by half of the court. In the instant case, the Pennsylvania Supreme Court took a longer period to grant the appeal and return a decision essentially adopting the opinion in support of reversal issued in the prior *Keystone* case. Such a result, however, violated none of PG&W's constitutional rights.

Initially, any suggestion that the lower Court's departure from precedent in reaching its decision was itself a violation of the Petitioner's constitutional rights is unsupportable. Like any court, the Pennsylvania Supreme Court is free to reexamine its precedent at any time in light of

changed circumstances or even changed Court composition. As noted by this Court in *Fidelity & Columbia Trust Co. v. City of Louisville,* 245 U.S. 54, 60 (1917), appellate courts are free to depart from precedents if on further reflection it thinks them wrong. In the instant case, the Pennsylvania Supreme Court simply examined its opinion in support of affirmance in the *Keystone* case, and found it to be incorrect.

The Petitioner's alternative argument that the Pennsylvania Supreme Court's inconsistent results in the *Keystone Water Co.* and the instant case violated its constitutional rights because they "involved appeals filed on the same day by the same party," likewise is unsupportable. As previously indicated, the Pennsylvania Supreme Court's affirmance of the intermediate appellate court's decision resulted only by operation of law, by virtue of the Court being equally divided on the issue. The opinion in support of reversal in *Keystone Water Co.* (Appendix F, page A111 of Petition) foreshadowed the result subsequently reached by the Court below in the instant case. This Honorable Court has held previously that *affirmance by an equally divided Court merely ends the process of direct review, settles no issue of law and is not entitled to precedential weight. Neil v. Biggers,* 409 U.S. 188, 192 (1972); *Laird v. Tatum,* 409 U.S. 824 (1972). A similar view has been adopted by the Pennsylvania Supreme Court. *Scibilia v. City of Philadelphia,* 279 Pa. 549, 124 A. 273 (1924). Therefore, the fact that the Supreme Court of Pennsylvania reached a result by operation of law in *Keystone Water Co.* that was inconsistent with the result reached in the instant case, is of no consequence.

CONCLUSION

For all of the foregoing reasons, this Honorable Court should deny Pennsylvania Gas and Water Company's Petition for a Writ of Certiorari to the Supreme Court of Pennsylvania.

Respectfully submitted,
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APPENDIX "A"

SUPREME COURT OF PENNSYLVANIA
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August 15, 1978

Re: PUC, Petitioner v. Pa. Gas & Water Co. (Water Div.)
City of Scranton, et al. v. Pa. Gas & Water Co. (Water Div.)

No. 195 Allocatur Docket

Dear Mr. Ferraro:

Please be advised that the Court has entered the following Orders on your Petition for Allowance of Appeal with Supersedeas from the Commonwealth Court in the above-captioned matter:

"June 21, 1978

Petition for Allowance of Appeal Granted.

s/ Per Curiam

"August 11, 1978

Petition for Supersedeas Granted.

s/ Nix, J.

Accordingly, your appeal has been docketed as of August 15, 1978 at No. 35 May Term, 1978. Appellant's briefs are due on or before October 2, 1978, and Appellee thirty days thereafter.

Very truly yours,
(s) Mildred E. Williamson
Deputy Prothonotary